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IN THE
Supreme Court of the United States

DYNEGY POWER MARKETING, INC., *ET AL.*,
Petitioners,
v.
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In *United Gas Pipeline Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), this Court established what is now known as the *Mobile-Sierra* doctrine. Under that doctrine, the Federal Energy Regulatory Commission ("FERC") may not overturn an agreed-upon contract rate for electricity in interstate commerce unless that rate "conflict[s] with the public interest." 350 U.S. at 346. "[T]he regulatory system created by the Act," this Court later observed, "is premised on contractual agreements voluntarily devised by the regulated companies; it contemplates abrogation of those agreements only in circumstances of unequivocal public necessity." *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968). The questions presented in this case are:

1. Whether, as held by the Ninth Circuit but contrary to decisions of the First and D.C. Circuits (as well as *Mobile* and *Sierra*), the *Mobile-Sierra* public interest standard of review is inapplicable to contracts that FERC accepts for filing but does not expressly approve.

2. Whether, as held by the Ninth Circuit but contrary to decisions of the First Circuit, a complainant may avoid application of the *Mobile-Sierra* public interest standard of review by claiming that it had imperfect information about market conditions when the contract at issue was accepted for filing by the Commission.

3. Whether, as held by the Ninth Circuit but contrary to decisions of the First and D.C. Circuits, FERC must replace the *Mobile-Sierra* public interest standard for modification of fixed contract rates and use a more lenient "zone of reasonableness" standard whenever purchasers claim that contract rates are too high (as opposed to sellers claiming rates are too low).

LIST OF PARTIES AND PARTIES TO THE PROCEEDINGS BELOW

Petitioners Dynegy Power Marketing, Inc., Cabrillo Power I LLC, El Segundo Power LLC, and Long Beach Generation LLC were intervenors in the court of appeals and respondents before the Federal Energy Regulatory Commission.

The following were also intervenors in the court of appeals and respondents before the Federal Energy Regulatory Commission: Sempra Generation (formerly Sempra Energy Resources); Mirant Americas Energy Marketing, L.P.; Coral Power; PPM Energy, Inc.

Respondent Public Utilities Commission of the State of California was a petitioner in the court of appeals and a complainant before the Federal Energy Regulatory Commission.

Respondent California Electricity Oversight Board was also a petitioner in the court of appeals and a complainant before the Federal Energy Regulatory Commission.

The Federal Energy Regulatory Commission was respondent in the court of appeals.

The following were intervenors in the court of appeals: Pacific Gas and Electric Company; Nevada Power Company; Southern California Edison Company; the Department of Water and Power of the City of Los Angeles; the Public Service Department of the City of Burbank; the Public Service Department of the City of Glendale; the Water and Power Department of the City of Pasadena; and Public Utility District No. 1 of Snohomish County, Washington.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, petitioners Dynegy Power Marketing, Inc., Cabrillo Power I LLC, El Segundo Power LLC, and Long Beach Generation LLC state the following:

Dynegy Power Marketing, Inc. is an indirect wholly owned subsidiary of Dynegy, Inc., a publicly held corporation. The only publicly held company that owns more than 10% of Dynegy, Inc.'s stock is Chevron U.S.A. Inc., which is an indirect wholly owned subsidiary of Chevron Corporation, a publicly held company. No publicly held company owns more than 10% of Chevron Corporation's stock. In addition, collectively, the following entities directly or indirectly own approximately 40% of Dynegy, Inc., but have no public shares outstanding: LS Associates; LSP Equity Partners; LSP Equity PIE; LSP Power Equity Partners, L.P.; LS Power Equity PIE I, L.P.; LS Power Gen Investors, L.P.; and LS Power Associates, L.P.

Cabrillo Power I LLC, El Segundo Power LLC, and Long Beach Generation LLC are each special purpose limited liability companies indirectly and wholly owned by NRG Energy, Inc., a publicly held corporation. No other publicly held company owns more than 10% of NRG Energy, Inc.'s stock.

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PETITION FOR A WRIT OF CERTIORARI

Dynegy Power Marketing, Inc., Cabrillo Power I LLC, El Segundo Power LLC, and Long Beach Generation LLC (collectively "Dynegy") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 474 F.3d 587. The order of the Federal Energy Regulatory Commission ("FERC") denying the complaint (Pet. App. 72a-204a) is reported at 103 FERC ¶ 61,354. FERC's order on rehearing (Pet. App. 17a-71a) is reported at 105 FERC ¶ 61,182.

JURISDICTION

The court of appeals entered its judgment on December 19, 2006. On March 6, 2007, Justice Kennedy extended the time for filing a petition for a writ of certiorari to and including May 3, 2007. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant provisions of the Federal Power Act ("FPA"), Public Utility Act of 1935, tit. II, ch. 687 49 Stat. 803, 838-63 (codified as amended at 16 U.S.C. §§ 791a-825r), are set forth at Pet. App. 306a-316a.

STATEMENT OF THE CASE

I. THE FEDERAL STATUTORY FRAMEWORK

A. The Federal Power Act

The FPA gives FERC "exclusive authority to regulate the transmission and sale at wholesale of electric energy in interstate commerce." *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 340 (1982); see 16 U.S.C. § 824. Section 205 of the Act requires that "[a]ll rates ... made, demanded, or received" by wholesale sellers of electricity be "just and reasonable," 16 U.S.C. § 824d(a), and bars discriminatory pricing, *id.* § 824d(b). Under § 205, sellers must file, "[u]nder such rules and regulations" and "within such time and in such form as [FERC] may designate," "schedules showing all rates and charges ... together with all contracts" for the sale of wholesale electricity in interstate commerce. *Id.* § 824d(c). Sellers must also notify FERC of proposed rate changes. See *id.* § 824d(d).

When a seller files a contract or a rate, it takes effect by operation of law absent action by FERC. See *id.* § 824d(e). FERC may, when accepting a proposed rate for filing, suspend it pending an investigation into lawfulness, and order refunds for sales that occur after the suspension ends but before it concludes its investigation. *Ibid.* FERC thus has a "passive and reactive role" under § 205. *City of Winnfield* v. *FERC*, 744 F.2d 871, 876 (D.C. Cir. 1984) (Scalia, J.).

Section 206 defines FERC's authority to change rates. Under it, FERC can (on its own motion or on complaint) investigate the lawfulness of any existing rate. 16 U.S.C. § 824e(a). If FERC finds a rate "unjust, unreasonable, unduly discriminatory or preferential," it must "determine the just and reasonable rate ... to be thereafter observed and

... shall fix the same by order." *Ibid.* FERC may order refunds of any unjust and unreasonable charges made after the investigation or complaint is initiated. See *id.* § 824e(b).

B. The *Mobile-Sierra* Doctrine

The *Mobile-Sierra* doctrine at issue here arises from this Court's twin decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) ("*Mobile*"), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) ("*Sierra*"). In those cases, sellers filed rate schedules and contracts with FERC's predecessor, the Federal Power Commission ("FPC"). In each case, the FPC accepted the contract for filing. *United Gas Pipe Line Co.*, 5 FPC 770 (1946); *Pac. Gas & Elec. Co.*, 7 FPC 832 (1948).

When market conditions changed, the sellers proposed new rate schedules to alter the contract rates. The FPC accepted the new rates for filing, but this Court overturned the orders. In *Mobile*, the Court declared that unilateral attempts to abrogate a previously-filed contract by submitting new rates for review are a "nullity." 350 U.S. at 339. The Court held that, even if the new rate would be just and reasonable, an existing contract rate may not be set aside unless it "conflict[s] with the public interest." *Id.* at 345.[1]

In *Sierra*, the Court held that the same standard applies *even if* the FPC, in accepting a new rate, finds that the prior contract rate would have been deemed unjust and unreasonable in a proceeding under FPA § 206. See 350 U.S. at 353-54. The Court explained that, if the rate is established by contract, the agency's authority is limited: "[A] contract may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility." *Id.* at 355. Instead, a contract rate is subject to abrogation as contrary to the "public interest" only if it "might impair the financial ability of a public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." *Ibid.* Because "[t]he regulatory system created by the Act is premised on contractual agreements voluntarily devised by the regulated companies, it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity." *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968).

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[1] While *Mobile* arose under the Natural Gas Act, key sections of that Act and the FPA are "substantially identical," 350 U.S. at 353, and the Court "cite[s] interchangeably decisions interpreting pertinent sections of the two," *Ark. La. Gas Co.* v. *Hall*, 453 U.S. 571, 577 n.7 (1981).

II. THE CONTRACTS AT ISSUE IN THIS CASE

A. California's Market Reforms and the Events of 2000 and 2001

In the 1990s, California legislators and regulators revised that State's electricity markets to move toward a competition-based structure. Investor-owned utilities ("IOUs") in California had previously met their customers' needs for power from various sources, such as using their own generation and buying under contract from other suppliers. California's new plan, however, generally required the IOUs to buy power from newly created "spot markets" involving hourly auctions administered by two new entities: the California Power Exchange ("PX") and California Independent System Operator ("ISO"). California's new regime thus required the IOUs to sell off most of their non-nuclear power plants, and largely prevented them from entering into long-term contracts with generators. California froze retail rates at then-current levels, minus 10 percent. Each IOU would exit the freeze once it recovered certain legacy costs associated with the restructured market design. See *San Diego Gas & Elec. Co.* v. *Sellers of Energy*, 93 FERC ¶ 61,121, at 61,351-52, 61,357 (2000) ("*SDG&E I*").

Because that market design restricted use of long-term power purchase contracts and divested the IOUs of much of their generation capacity, it left them "exposed . . . to the volatility of the spot market." *Id.* at 61,354. Even after price spikes in other spot markets exposed that vulnerability,[2] California continued to bar the IOUs from using significant longer-term contracts. *San Diego Gas & Elec. Co.* v. *Sellers of Energy*, 93 FERC ¶ 61,294, at 61,999-62,001 (2000) ("*SDG&E II*").

Between May 2000 and June 2001, the Western United States—particularly California—experienced a period of prolonged price spikes. The primary causes were increased demand throughout the West (which saw region-wide high temperatures) and supply constraints from reduced imports, outages at nuclear plants, and other factors. See *SDG&E I*, 93 FERC at 61,353, 61,357-60. Because California's restructuring plan largely foreclosed long-term contracts and erroneously assumed that spot market prices would remain stable, the IOUs subject to the rate freeze had no way to recover dramatically increased costs. See *id.* at 61,353. Thus, "[m]any of the market dysfunctions in California and exposure of California customers to high prices can be traced directly to an over reliance on spot markets" mandated by California. *Id.* at 61,359. As the IOUs' financial condition deteriorated, sellers became increasingly reluctant to sell into the spot markets because they feared that they would not be paid if the IOUs defaulted. See generally *Cal. Indep. Sys. Op. Corp.*, 94 FERC ¶ 61,132 (2001). In mid-December 2000, the U.S. Secretary of Energy responded by ordering suppliers to sell in shortage conditions. DOE Order Pursuant to Section 202(c) of the Federal Power Act (Dec. 14, 2000).

Throughout the period of price spikes, many entities—including respondents California Public Utilities Board ("CPUC") and the California Electricity Oversight Board ("CEOB")—filed complaints and other pleadings with

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[2] In 1998, Midwest spot market prices temporarily skyrocketed from an average of $25 to as high as $7,500 per megawatt-hour; there were similar price spikes in the Midwest the next year. See FERC Staff Report on the Causes of Wholesale Electric Pricing Abnormalities in the Midwest During June 1998 at vi (Sept. 22, 1998); Energy Information Administration, 1 Electric Power Annual 1999 at 3 (2000).

FERC contending that sellers were exercising market power or otherwise manipulating markets.[3]

B. FERC Seeks To Eliminate California's Excessive Reliance on Spot Markets

In December 2000, after taking comments on the mounting crisis, FERC issued an order that "strongly urge[d] the IOUs to move their load to long-term contracts of two years or more." *SDG&E II*, 93 FERC at 61,993. To that end, FERC eliminated the requirement that the IOUs buy exclusively from the PX spot market. *Id.* at 61,982.

FERC rejected the claim that "prices in the forward markets [would] be affected by" the prior "summer's spiraling spot prices and should therefore be deemed unreasonable." *Id.* at 61,994. FERC explained that suppliers had a strong incentive to avoid risk and lower prices to "benefit from the stable revenue stream of forward markets," and that FERC's reforms would reduce anticipated spot-market prices and thus any effect on forward markets. *Ibid.*

Turning to the spot market, FERC found that an imbalance in supply and demand played a "major role" in the price spikes. *Id.* at 61,984. FERC took several remedial steps, such as cost-based review of certain supplier bids. *Id.* at 61,983. FERC also found that, while sellers had an "opportunity" to exercise market power, *id.* at 61,984, there was "not sufficient evidence" to determine whether they actually had done so, *id.* at 61,998.

C. The Long-Term Contracts at Issue Here

In January 2001, California authorized its Department of Water Resources ("CDWR") to enter into long-term contracts as a creditworthy purchaser on behalf of the IOUs.[4] CDWR—now effectively the sole purchaser of power for almost the entire State of California—solicited 213 offers from suppliers, including petitioner Dynegy, for long-term power contracts. Pet. App. 96a. In early March, Dynegy and CDWR entered into an almost four-year contract providing California with 1000 MW of capacity for the 2001 peak summer season, and up to 2100 MW of capacity for later periods—at prices well below prevailing spot levels. Prepared Direct Testimony of Lynn Lednicky, Dkt. Nos. EL02-60, *et al.*, at 21-24, 28-29 (Oct. 17, 2002).

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[3] On August 29, 2000, CEOB filed a complaint alleging market power and market manipulation; it later submitted expert reports and other evidence. See *SDG&E II*, 93 FERC at 61,986; CEOB Comments and Request for Rehearing, Dkt. Nos. EL00-95-004, *et al.*, at vii (Nov. 22, 2000). The CPUC filed similar materials. See Response and Request for Rehearing, Dkt. Nos. EL00-95-004, *et al.*, at 4 (Nov. 22, 2000).

Dynegy submitted its CDWR contract to FERC in early April 2001 under § 205 of the FPA, 16 U.S.C. § 824d(c).[5] Respondents CPUC and CEOB intervened but "rais[ed] no substantive issues." *Dynegy Power Mktg., Inc.*, 95 FERC ¶ 61,371, at 62,401 (2001). FERC accepted the contract for filing in June 2001, with an effective date of March 6, 2001. *Ibid.* No party sought rehearing or judicial review.

III. PROCEEDINGS BELOW

A. Proceedings at FERC

The crisis abated in mid-2001 as energy supplies rose and prices declined throughout the Western United States. Pet. App. 79a-80a. In 2002, the CPUC and CEOB filed complaints with FERC under FPA § 206 seeking to abrogate CDWR's long-term contracts, including the contract with Dynegy. Although CDWR had lauded those contracts as "fair, negotiated, hard-fought deals," *id.* at 97a—and Californians had benefited from the contracts' below spot-market prices during 2001—the CPUC and CEOB now condemned the contracts as unjust and unreasonable.

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[4] Proclamation, Cal. Gov. (Jan. 17, 2001). That decision followed meetings among the Secretaries of Treasury and Energy, the Chairman of the National Economic Council, the Chairman of FERC, California's Governor, California legislators and the Chairman of the CPUC, as well as executives from California utilities and large power generators, including Dynegy. The attendees sought ways for California to enter into long-term contracts, and sought a creditworthy buyer to replace the nearly insolvent IOUs. Prepared Direct Testimony of Lynn Lednicky, Dkt. Nos. EL02-60, *et al.*, at 7-9 (Oct. 17, 2002). Days later, the credit ratings of two of the IOUs were downgraded and they began defaulting on hundreds of millions of dollars owed for power purchases. *Cal. Indep. Sys. Op.*, 94 FERC at 61,507.

[5] During the relevant period, FERC did not require contracts to be filed. Instead, its market-based-rate program provided for periodic reporting and examinations of potential seller market power. Pet. App. 112a-115a.

After an extensive hearing that included testimony by expert and fact witnesses, FERC denied the complaints. *Id.* at 73a-74a. FERC found that the contracts could be modified only under the "public interest" standard articulated in *Mobile-Sierra. Id.* at 74a. After examining the "totality of the circumstances"—including evidence from other investigations of the western energy crisis—FERC found "nothing in the record . . . to support a finding that there was market manipulation *specific to* the long-term contract negotiations," and "no evidence of unfairness, bad faith, or duress." *Id.* at 101a-102a. "[T]he contracts at issue were the result of choices voluntarily made by CDWR " *id.* at 101a, which (as the only creditworthy purchaser in the State) had "a great deal of bargaining power," *id.* at 98a.

FERC held that the CPUC and CEOB had not established any of the three public interest factors under *Mobile-Sierra* (see pp. 3-4, *supra*), or any other public interest consideration that justified relief. Pet. App. 46a-47a. After considering evidence regarding alleged manipulation and market power abuse, FERC found that any impact on forward prices from spot market dysfunctions was insufficient to warrant contract modification, particularly in light of California's failure "to demonstrate that the contracts were priced above long-run competitive prices." *Id.* at 93a. Although California argued that the contracts incorporated a "significant premium" due to the alleged influence of high spot-market prices, FERC found that "both buyers and sellers have an equal incentive to avoid the price risks innate to spot market sales and to obtain the security long-term contracts provide." *Id.* at 54a. Indeed, when the contracts were negotiated, California had declared a goal of obtaining a contract portfolio with an average price of no more than $70 per megawatt-hour—a price that would not cause retail rate increases for consumers—and the contracts were consistent with that goal. *Id.* at 93a. Finally, FERC emphasized the importance of contract stability: "Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty." *Id.* at 45a. Accordingly, FERC held that the CPUC and CEOB had failed to make the public interest showing necessary to justify relief. *Id.* at 47a-48a.

B. Proceedings in the Ninth Circuit

The CPUC and CEOB petitioned for review and, more than two years after oral argument, the Ninth Circuit reversed in this case, Pet. App. 1a-16a, and a companion case decided the same day, *Public Utility District No. 1* v. *FERC*, 471 F.3d 1053 (2006) ("*PUD*") (Pet. App. 240a-305a).

1. The Ninth Circuit rejected FERC's conclusion that the *Mobile-Sierra* doctrine applies here. Instead, the Ninth Circuit imposed two new pre-conditions to that doctrine's application.[6] First, the Ninth Circuit stated that *Mobile-Sierra*'s demanding public interest test applies only if "the regulatory scheme in which the contracts are formed ... provide[s] FERC with an opportunity for effective, timely review of the contracted rates." Pet. App. 3a (quoting *PUD*, Pet. App. 250a). Second, the Ninth Circuit declared that "where ... FERC is relying on a market-based rate-setting system to produce just and reasonable rates, this review must permit consideration of all factors relevant to the propriety of the contract's formation." *Id.*

The Ninth Circuit ruled that those preconditions prohibited application of the *Mobile-Sierra* public interest "mode of review" to the market-rate contracts at issue that (unlike Dynegy's contract) had not been submitted for filing at FERC. FERC's market-based rate scheme, the court held, "precludes timely consideration of sudden market changes and offers no protection to purchasers victimized by the abuses of sellers or dysfunctional market conditions that FERC itself only notices in hindsight." Pet. App. 11a (quoting *PUD*, Pet. App. 294a).

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[6] The parties to a contract can agree to a lesser standard in the contract itself. See *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.*, 358 U.S. 103, 112-16 (1958) ("*Memphis*"). The contracts at issue here did not contain such language. Pet. App. 11a & n.8.

The Ninth Circuit recognized that Dynegy's contract, unlike the others, had been submitted to FERC for filing, noticed for public comment, and accepted by FERC for filing. Pet. App. 11a (citing *Dynegy Power Mktg.*, 95 FERC at 62,401). But the Ninth Circuit held that *Mobile-Sierra* could not apply to the Dynegy contract, absent further inquiry, because FERC had merely *accepted* that contract for filing without *approving* the rate the parties had agreed upon. The court relied on FERC's statement that its order accepting the contract for filing "did not constitute approval" and was "without prejudice to any findings or orders which ... may hereafter be made by the Commission." Pet. App. 11a-12a (quoting 95 FERC at 62,401). The Ninth Circuit also stated that the filing did not "permit consideration" of all relevant factors because "any challenge to the contract at the time FERC sought public comments would have been hampered by limited information: At the time Dynegy filed its contract, the full scale of market manipulation and forward market dysfunction was not nearly as fully known as it is today." *Id.* at 12a.

Finally, the Ninth Circuit held that, even if *Mobile-Sierra* applied, FERC had used "an erroneous standard for determining whether the challenged contracts affect the public interest." Pet. App. 13a (quoting *PUD*, Pet. App. 298a-299a). The Ninth Circuit noted that *Mobile* and *Sierra* had articulated a demanding standard, but distinguished those cases because they involved a seller complaining that the contract rates were too low. The concerns in cases where "the customer is complaining of a *high* rate," the

Ninth Circuit stated, "are not entirely parallel to those in a low-rate case." *PUD*, Pet. App. 301a. The "proper standard . . . in a high-rate challenge," the Ninth Circuit declared, "is not whether the contracted rates pose an 'excessive burden' on consumers, but whether the wholesale energy contract is outside the 'zone of reasonableness' and results in retail rates higher than would be the case if that zone were not exceeded." *Id.* at 303a. The Ninth Circuit thus granted the petition for review and remanded to FERC. Pet. App. 16a.

REASONS FOR GRANTING THE PETITION

For 50 years, the *Mobile-Sierra* doctrine has precluded FERC from invoking the FPA's "just and reasonable rate" requirement to abrogate interstate energy contracts to "relieve[]" a contracting party "of its improvident bargain." *Sierra*, 350 U.S. at 355. Instead, the statutory scheme "contemplates abrogation of these agreements only in circumstances of *unequivocal public necessity*." *Permian Basin*, 390 U.S. at 822 (emphasis added). The Ninth Circuit's decision eviscerates that bedrock principle and creates multiple divisions in circuit authority in the process.

First, the Ninth Circuit held that, even when FERC has accepted a contract for filing, the *Mobile-Sierra* doctrine is inapplicable if FERC has not *approved* the contract terms. By contrast, the First and D.C. Circuits have long recognized that *Mobile-Sierra* applies at least to all contracts accepted by FERC even absent approval. Indeed, the contracts at issue in *Mobile* and *Sierra* themselves—like Dynegy's contracts here—had been accepted by FERC but not approved. The Ninth Circuit thus held that the *Mobile-Sierra* doctrine would not apply even in the very decisions of this Court that established that doctrine. The Ninth Circuit also created a circuit conflict when it required FERC to disregard *Mobile-Sierra* because the "scale of spot market manipulation and . . . dysfunction" was not "as fully known" at the time of contract filing as it is today. Pet. App. 12a. A complainant's allegations of market dysfunction or manipulation may be relevant when deciding whether the *Mobile-Sierra* public interest test has been satisfied. But such allegations do not prevent the *Mobile-Sierra* public interest test from applying in the first place.

Second, the Ninth Circuit radically altered the substance of "public interest" review under *Mobile* and *Sierra* by establishing separate tests for cases that challenge rates as too low and cases that challenge rates as too high. Pet. App. 14a. The First and D.C. Circuits have repeatedly rejected that approach, refusing to transform public interest review into a one-way street that favors buyers over sellers. Indeed, they have rejected the very standard the Ninth Circuit imposed here as contrary to *Mobile* and *Sierra*.

These issues are important and recurring. The Ninth Circuit's decision all but renders *Mobile-Sierra* a dead letter, destroying the certainty of contracts that the doctrine was designed to create. The result is new-found risk that will increase prices in the long run. The contracts at issue in this case alone are valued in billions of dollars. But the damage is far more pervasive. Only this Court can redress the disruption to the energy markets caused by the decisions below.

I. THE NINTH CIRCUIT'S RATIONALE FOR REJECTING *MOBILE-SIERRA*'S APPLICATION CREATES A CIRCUIT CONFLICT AND EVISCERATES *MOBILE-SIERRA*

When Congress enacted the FPA, it sought to accommodate the competing concerns of "contract stability on the one hand and public regulation on the other." *Mobile*, 350 U.S. at 344. In striking that balance, "Congress departed from the [traditional] scheme of purely tariff-based regulation" by permitting parties to set rates through privately negotiated contracts. *Verizon Commc'ns, Inc.* v. *FCC*, 535 U.S. 467, 479 (2002); see *Mobile*, 350 U.S. at 338 (noting the "marked contrast" with earlier regulatory statutes). In wholesale electricity markets, contracting parties are "often sophisticated businesses enjoying presumptively equal bargaining power, who c[an] be expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon*, 535 U.S. at 479. "[T]he regulatory system created by the Act" thus "is premised" on preserving "contractual agreements voluntarily devised by the regulated companies." *Permian Basin*, 390 U.S. at 822.

Correspondingly, the FPA limits FERC's authority to replace contract rates under the "just and reasonable" standard. Under the *Mobile-Sierra* doctrine, FERC cannot set aside a rate established by contract merely because FERC might believe a different rate is just and reasonable. *Sierra*, 350 U.S. at 355. Instead, FERC must find that the existing contract rate "conflict[s] with the public interest." *Mobile*, 350 U.S. at 345. That public interest standard is "much more restrictive" than the ordinary "just and reasonable" standard. *Atl. City Elec. Co.* v. *FERC*, 295 F.3d 1, 14 (D.C. Cir. 2002); *Transmission Access Policy Study Group* v. *FERC*, 225 F.3d 667, 710 (D.C. Cir. 2000). Changing the rate must be an "unequivocal public necessity," *Permian Basin*, 390 U.S. at 822; the rate must "impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." *Sierra*, 350 U.S. at 355. "By preserving the integrity of contracts," the *Mobile-Sierra* doctrine—including its demanding public interest standard—"permits the stability of supply arrangements which all agree is essential to the health of the . . . industry." *Mobile*, 350 U.S. at 344.

The Ninth Circuit's decision in this case, however, declares that *Mobile-Sierra*'s public interest test does not protect filed contract rates unless FERC approves those rates, and conditions the doctrine's application on a prior determination that the contracts were "initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." Pet. App. 12a (quoting *PUD*, Pet. App. 296a). Those holdings conflict with decisions of the D.C.

and First Circuits; conflict with *Mobile* and *Sierra* themselves (both of which involved filed rates that were not approved); and effectively read *Mobile* and *Sierra* right out of the U.S. Reports.

A. The Ninth Circuit's Decision Refusing *Mobile-Sierra* Protection for Filed Contracts Conflicts With Decisions of the First and D.C. Circuits

Announcing a new precondition to protection of contract rates under the *Mobile-Sierra* doctrine, the Ninth Circuit held that FERC may not "apply the *Mobile-Sierra* 'public interest' mode of review" to a contract rate unless "the regulatory scheme in which the contracts are formed . . . provide[s] FERC with an opportunity for effective, timely review of the contracted rates." Pet. App. 10a (quoting *PUD*, Pet. App. 295a). Here, FERC (and all affected parties) had exactly such an opportunity. Dynegy filed its contract with FERC; FERC published it for public comment; respondents CPUC and CEOB intervened without raising any substantive issues; and FERC then accepted the contract for filing. See p. 7, *supra.*

The Ninth Circuit nonetheless refused to apply *Mobile-Sierra* because FERC accepted but did not "approve" the CDWR contract, citing FERC's statement that its acceptance did "not constitute *approval* of any . . . rate." Pet. App. 11a-12a. While the distinction between "accepting" and "approving" a rate or contract can have significance in other contexts,[7] the First Circuit and D.C. Circuits have held that *Mobile-Sierra* applies to contracts that are approved *or* accepted. Unless the parties have agreed otherwise by contract, once contract rates are "*accepted for filing*, FERC may subsequently order modification *only* upon finding that the modification is required by the 'public interest.'" *Me. Pub. Utils. Comm'n* v. *FERC*, 454 F.3d 278, 283-84 (D.C. Cir. 2006) (emphasis added). "[T]he *Mobile* and *Sierra* decisions," those courts recognize, "held that where the electrical utility (or natural gas company) and its customer have contracted for a particular rate, and the agency has *accepted the contract for filing*, . . . the agency's power under section 206 to alter the existing contract rate under the just and reasonable standard is . . . curtailed." *Boston Edison Co.* v. *FERC*, 233 F.3d 60, 65 (1st Cir. 2000) (citing *Sierra*, 350 U.S. at 352-55; *Mobile*, 350 U.S. at 347); see *id.* at 68 (rejecting FERC's attempt to impose new requirements "after contracts have been drafted, signed, *accepted for filing* by FERC, and implemented") (emphasis added). "[T]ackl[ing] head-on the question of *whether FERC's initial acceptance of the contract for filing* placed [the contract] within the sheltered lee of the filed rate and *Mobile-Sierra* doctrines," the First Circuit has clearly held that, under its "reading of the Federal Power Act, the applicable regulations, and the caselaw," acceptance has pre-

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[7] In general, FERC "approves" a contract only at the close of *litigated* proceedings and "accepts" all other contracts (which constitute the vast majority of cases). FERC's regulations thus state that the "acceptance for filing of any tariff, contract or part thereof does not constitute approval . . . ." 18 C.F.R. § 154.6 (2006) (NGA); *accord id.* § 35.4 (FPA). That has been the rule since the FPA and NGA were enacted. Provisional Rules of Practice and Regulation Under the Natural Gas Act, Order No. 52, § 53.4F, 3 Fed. Reg. 1681, 1687 (July 12, 1938); Miscellaneous Amendments, Order No. 144, 13 Fed. Reg. 6,371, 6,373 (Oct. 30, 1948); Miscellaneous Amendments, Order No. 271, 28 Fed. Reg. 10,573,

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10,574 (Oct. 2, 1963). FERC's clarification that acceptance is not approval ensures that contracting parties can renegotiate and file revised rates under FPA § 205. See, *e.g.*, *Mobile*, 350 U.S. at 342-43. And it ensures that the rule of *Arizona Grocery Co.* v. *Atchison, T & S.F. Ry. Co.*, 284 U.S. 370 (1932), does not prevent challenges to filed rates entirely. *Arizona Grocery* distinguished between "legal rates" that are "accepted for filing" in quasi-adjudicatory proceedings (which may be changed under certain circumstances), and "lawful rates" that are "approved" in quasi-legislative proceedings (which for the covered period cannot). See, *e.g.*, *Verizon Tel. Cos.* v. *FCC*, 269 F.3d 1098, 1108 (D.C. Cir. 2001) ("[T]he Court in *Arizona Grocery* made clear that there is an important distinction between rules resulting from quasi-adjudication and rules resulting from quasi-legislation. We are therefore bound to . . . apply this distinction.").

cisely that effect. *Boston Edison Co.* v. *FERC*, 856 F.2d 361, 371 (1st Cir. 1988) (emphasis added).

Those courts thus do not discriminate between "accepted" contracts and "approved" contracts, much less reserve *Mobile-Sierra* protection for the latter. See *id.* at 369 & n.6 (applying *Mobile-Sierra* to contract accepted for filing even though FERC regulations state that acceptance for filing "shall not constitute approval," and FERC's order expressly "reaffirmed that 'acceptance for filing does not constitute approval'"); *Potomac Elec. Power Co.* v. *FERC*, 210 F.3d 403, 409 (D.C. Cir. 2000) (describing contract subject to *Mobile-Sierra* as both "accepted" and "approved" where FERC's original order accepted contract for filing while noting that "acceptance" does not constitute "approval," see *Monongahela Power Co.*, 39 FERC ¶ 61,350, at 62,096 n.21 (1987)). That makes sense: As discussed below (pp. 17-18, *infra*), contracts take effect automatically once filed unless FERC takes affirmative action to suspend them. As a result, while courts sometimes use "accepted" and "approved" interchangeably, *e.g., Me. Pub. Utils. Comm'n*, 454 F.3d at 283, most cases applying *Mobile-Sierra*—including *Mobile* and *Sierra* themselves—apply that doctrine to contracts that FERC has accepted but not approved.

Indeed, recognizing the critical role of private contracts under the FPA, the D.C. and Fifth Circuits have held that *Mobile-Sierra* applies even absent filing. See *Sam Rayburn Dam Elec. Coop.* v. *FPC*, 515 F.2d 998, 1008-1010 (D.C. Cir. 1975); *Borough of Lansdale* v. *FPC*, 494 F.2d 1104, 1113 (D.C. Cir. 1974); *Compania de Gas de Nuevo Laredo, S.A.* v. *FERC*, 606 F.2d 1024, 1028-29 (D.C. Cir. 1979); *Natural Gas Pipeline Co.* v. *Harrington*, 246 F.2d 915, 919 (5th Cir. 1957). For that reason, other parties have filed persuasive petitions for a writ of certiorari challenging the Ninth Circuit's holding that FERC's market-based rate program did not provide sufficient prior review to support *Mobile-Sierra*'s public interest standard. Dynegy supports those petitions. But given the Fifth and D.C. Circuits' holdings that *Mobile-Sierra* applies even to *unfiled* contracts, it should follow *a fortiori* that *Mobile-Sierra* also applies to contracts that—like Dynegy's—are filed with FERC, noticed for comment, and accepted for filing.

B. The Ninth Circuit's "Approval" Rule Also Conflicts With—and Eviscerates—*Mobile* and *Sierra*

The Ninth Circuit's new "approval" requirement also conflicts with this Court's decisions in *Mobile* and *Sierra*. In those cases, the Commission orders accepting the contracts for filing included *virtually the same language* withholding approval that the Ninth Circuit invoked to preclude application of *Mobile* and *Sierra* here.[8] The Ninth Circuit's effort to confine *Mobile-Sierra* to contracts that FERC approves thus contradicts *Mobile* and *Sierra* themselves.

The Ninth Circuit's decision also defies the FPA. As this Court has held, the FPA "is premised" on preserving "contractual agreements voluntarily devised by the regulated companies." *Permian Basin*, 390 U.S. at 822. Hence, if FERC takes no action once a rate or contract is filed, the rate or contract takes effect by operation of law. See 18 U.S.C. § 824d(e). While FERC often accepts a rate or contract for filing, it need not do so. A new or changed rate is not "effected . . . by an order of the Commission but solely by virtue of the . . . company's own action." *Mobile*, 350

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[8] In this case, the Ninth Circuit relied on FERC's statement declaring that its acceptance of the Dynegy contract "does not constitute approval of any . . . rate; and such action is without prejudice to any findings or order which . . . may hereafter be made by the Commission." Pet. App. 11a-12a (quoting *Dynegy Power Mktg., Inc.*, 95 FERC ¶ 61,371 at 62,401). The agency orders this Court reviewed in *Mobile* and *Sierra* similarly provided: "Nothing contained in this order shall be construed as constituting approval by this Commission of any . . . rate . . . or . . . contract [and] is without prejudice to any findings or orders which . . . may hereafter be made by this Commission." *Pac. Gas & Elec. Co.*, 7 FPC 832 (1948); *United Gas Pipe Line Co.*, 5 FPC 770 (1946). The Ninth Circuit itself recognized that the contracts in *Mobile* and *Sierra* were "accepted" but not "approved." See *PUD*, Pet. App. 247a (noting that the contract in *Mobile* was "accepted . . . for filing").

U.S. at 342; see *Boston Edison Co.*, 856 F.2d at 369 ("As a rule, an initial rate filing takes effect automatically."); *Lansdale*, 494 F.2d at 1110 (similar). In no event, however, is FERC required to *approve* a rate or contract. As this Court explained in the related filed-rate context, "the right to a reasonable rate is the right" to the "filed rate, *whether fixed or merely accepted by the Commission* . . . ." *Montana-Dakota Utils. Co.* v. *Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951) (emphasis added).

By conditioning application of the *Mobile-Sierra* public interest standard on FERC rate approval, the Ninth Circuit's decision sets the FPA's contract-based structure on its head. *Mobile-Sierra* is a limit on FERC's authority to alter private contracts. That protection has never depended on prior FERC approval (a process that would require extensive hearings and fact-finding for each of the myriad contracts within FERC's jurisdiction). For that reason, the D.C. Circuit and the Fifth Circuit have long held that *Mobile-Sierra* protects contracts even where there was an obligation to file them but the parties failed to do so. See *Sam Rayburn*, 515 F.2d at 1008-1010; *Lansdale*, 494 F.2d at 1113; *Harrington*, 246 F.2d at 919; p. 16, *supra*.

The Ninth Circuit fundamentally misconstrued FERC's caveat that acceptance is not approval. FERC does not have authority to (and has not attempted to) overrule *Mobile* and *Sierra* by adding caveats when accepting rates. FERC's caveat serves other purposes entirely—and appears in virtually every FERC rate order. See pp. 14-15 & n.7, *supra*. The Ninth Circuit's decision thus blinks the *Mobile-Sierra* doctrine out of existence almost entirely.[9]

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[9] It is no answer to suggest that FERC can simply begin "approving" contracts as required by the panel. FERC has sometimes been too quick to change contracts where the parties originally intended to preclude such action. See, *e.g.*, *Boston Edison Co.*, 233 F.3d at 68 (urging that, although FERC is "hostile to *Mobile-Sierra*," it should "stop trying to rewrite deals that the parties have already made"). *Mobile-Sierra* thus serves as a limit on FERC's authority. Giving

C. The Ninth Circuit Compounded Its Error and the Conflict By Requiring Relitigation Of The Contract As A *Precondition* To *Mobile-Sierra* Review

Having refused to apply *Mobile-Sierra* to a contract that FERC had accepted for filing, the Ninth Circuit then exacerbated that error by requiring fact-intensive litigation to determine whether *Mobile-Sierra*'s public interest test applies at all. The Ninth Circuit held that "*Mobile-Sierra* cannot apply without *a determination* that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." Pet. App. 12a (quoting *PUD*, Pet. App. 295a-296a) (emphasis added). That is true, the Ninth Circuit held, even absent "evidence of unfairness, bad faith, or duress," because it is "the *context*, not the conduct, of those negotiations" that matters. *PUD*, Pet. App. 297a (emphasis added). The court therefore held that Dynegy's contract was not entitled to *Mobile-Sierra* protection as a threshold matter because, "[a]t the time Dynegy filed its contract, the full scale of market manipulation and forward market dysfunction was not nearly as fully known as it is today." Pet. App. 12a.

Those holdings cannot be reconciled with *Northeast Utilities Service Co.* v. *FERC*, 993 F.2d 937 (1st Cir. 1993). In that case, the First Circuit held that FERC could not avoid *Mobile-Sierra* simply because the seller had market power:

> As for the seller's market power, reliance on this factor threatens to erode the *Mobile-Sierra* doctrine so substantially that a fuller explanation . . . is required . . . . [S]ome measure of market power could be

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FERC full control over election of the public interest standard therefore is antithetical to the doctrine. In any event, contract volume alone makes it unlikely that FERC could "approve" even a fraction of rates. And "approving" contracts might make it impossible to alter them without extensive proceedings. See pp. 14-15 & n.7, *supra*.

> present in a large number of contracts. A case-by-case inquiry into the presence and extent of market power would inject a new and potentially time-consuming element into the *Mobile-Sierra* analysis, and it is not entirely clear in any event why the Commission should protect a buyer who voluntarily enters into an agreement with a dominant seller.

Id. at 961; cf. *San Diego Gas & Elec. Co.* v. *FERC*, 904 F.2d 727, 730 (D.C. Cir. 1990) (upholding FERC's application of *Mobile-Sierra* where dramatic price changes created "buyer's remorse"; rejecting the claim that FERC "did not give enough weight to market changes between the execution of the agreement and the time for its performance").

The First Circuit thus has held that, because "a case-by-case inquiry into the presence and extent of market power would inject a new and potentially time-consuming element into the *Mobile-Sierra* analysis," and because it would "erode the *Mobile-Sierra* doctrine so substantially," FERC *cannot refuse* to apply *Sierra-Mobile* public interest review merely because the seller had market power. By contrast, in this case, the Ninth Circuit *required* FERC to *refuse* to apply *Mobile-Sierra* public interest review whenever the contract was "influence[d]" by any of a variety of factors, such as "market power" or "dysfunctional markets." Indeed, the Ninth Circuit held that mere imperfect information is sufficient to preclude *Mobile-Sierra* public interest review. A more clear-cut conflict is difficult to imagine.

The issues identified by the Ninth Circuit (market failure or manipulation) may be relevant to *whether* an effort to alter a contract rate *meets* the public interest standard under *Mobile-Sierra*. FERC could, for example, consider the impact of market manipulation as part of its public interest analysis. But such considerations are not relevant to whether the public interest test governs in the first place. To the contrary, as explained above (pp. 14-16, *supra*), the other courts of appeals have concluded that, at least once

FERC accepts a contract for filing, *any* subsequent challenge to the contract rate must proceed under the *Mobile-Sierra* public interest standard.

The Ninth Circuit's decision—to disregard *Mobile-Sierra* whenever additional information about market dysfunction and manipulation emerges after FERC accepts the rate—also contravenes settled contract and regulatory principles. For example, the filed rate doctrine bars belated attacks on the reasonableness of rates "fixed or merely accepted" by FERC under FPA § 205. *Montana-Dakota*, 341 U.S. at 251-52. Objections to a filed rate must be made on direct review "or not at all." *City of Tacoma* v. *Taxpayers*, 357 U.S. 320, 336 (1958); see *Ark. La. Gas Co.* v. *Hall*, 453 U.S. 571, 578 (1981). The courts of appeals have held that even fraud by a *contractual counterparty* is insufficient to violate the sanctity of a rate filed with FERC.[10] Yet the Ninth Circuit's decision in this case would go so far as to refuse *Mobile-Sierra* protection based on alleged misconduct *by third parties*.

Here, the CPUC and CEOB had the opportunity to challenge Dynegy's contract when it was submitted to FERC. Indeed, they intervened in the FERC proceedings, but raised no substantive issues and never sought rehearing or judicial review. FERC's order accepting the Dynegy contract therefore became final and non-reviewable. See *City of Tacoma*, 357 U.S. at 336-37. The CPUC and CEOB cannot demand lower rates based "on speculation about what the Commission might have done had it been faced with [different] facts." *Ark. La.*, 453 U.S. at 578-79. Instead, they must show that the filed contract rate is inconsistent with the public interest under *Mobile-Sierra*.

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[10] Courts of appeals have "concluded that filed rate preemption applies even where the claim is that a rate was procured by fraud." *Transmission Agency of N. Cal.* v. *Sierra Pac. Power Co.*, 295 F.3d 918, 933 (9th Cir. 2002); see *Taffet* v. *S. Co.*, 967 F.2d 1483, 1494-95 (11th Cir. 1992); *S. Union Co.* v. *FERC*, 857 F.2d 812, 818 (D.C. Cir. 1988) (negligent misrepresentation).

The impact of market dysfunction or manipulation may be relevant to whether they can meet their burden. But it is not a precondition to applying *Mobile-Sierra*.

Ultimately, the Ninth Circuit's new rule is at war with the core principle of contract stability that undergirds *Mobile-Sierra* and the FPA. See pp. 12-13, *supra*. It can always be said that certain circumstances were not "nearly as fully known" in the past as they are today, but contracts would have little meaning if mere imperfect information were sufficient to defeat them.[11] Fixed-price contracts are all about allocating risks. See *Northern Ind. Pub. Serv. Co.* v. *Carbon Cty. Coal Co.*, 799 F.2d 265, 275-78 (7th Cir. 1986). The contract here was no exception. When that contract was negotiated, signed, and accepted by FERC, FERC had already found that the spot markets were dysfunctional; claims of market manipulation in those markets abounded; and California claimed that dysfunction in spot markets would affect prices in forward markets as well. See pp. 5-8, *supra*. CDWR chose, however, to hedge its risk by entering into a fixed-price contract with Dynegy nonetheless. In so doing, it successfully transferred the risk of further high prices—whether they were caused by dysfunction, scarcity, or other factors—to Dynegy, and locked in, for California, lower-than then-prevailing market prices for almost four years. The Ninth Circuit's decision undoes that allocation of risk, allowing CDWR to escape its bargain because the risks it transferred to Dynegy abated over time. That cannot be reconciled with established contract principles, much less the rigors of the *Mobile-Sierra* public interest test.

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[11] As the Eighth Circuit has explained: "Contracting parties rarely, if ever, make their agreements with full knowledge of every relevant fact .... Instead, it is the office of the contract to allocate the risks of error between the parties." *Doe* v. *Nebraska*, 345 F.3d 593, 603-604 (8th Cir. 2003) (citing Rest. 2d Contracts § 154 (1981) ("[A] party bears the risk of a mistake when . . . he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient.")).

II. THE NINTH CIRCUIT'S RECONFIGURATION OF THE PUBLIC INTEREST TEST CONFLICTS WITH DECISIONS OF OTHER COURTS AND THIS COURT

The Ninth Circuit's decision also creates a circuit conflict on the nature of the "public interest" test under *Mobile* and *Sierra*. The Ninth Circuit held that the standards this Court articulated to govern the public interest inquiry apply only when a seller challenges rates as too low—and that a more lenient "zone of reasonableness" standard applies when a purchaser challenges a rate as too high. That holding conflicts with decisions of the First and D.C. Circuits as well as this Court's precedents.

A. The Ninth Circuit's Decision Conflicts with Decisions Of the First and D.C. Circuits

When *Mobile* and *Sierra* held that FERC may not set aside a contractually agreed-upon rate as "unjust or unreasonable" unless it "conflicts with the public interest," *Mobile*, 350 U.S. at 387, the Court identified three factors that should be considered in making that determination—whether the rate "might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory," *Sierra*, 350 U.S. at 355. Under that standard, FERC is not at liberty to relieve a contracting party "of its improvident bargain" or otherwise declare "a contract . . . to be either 'unjust' or 'unreasonable' simply because it is unprofitable . . . . " *Id.* Rather, the statute "contemplates abrogation" of contract rates "only in circumstances *of unequivocal public necessity*." *Permian Basin*, 390 U.S. at 822.

The First and D.C. Circuits have repeatedly recognized that *Mobile-Sierra*'s restrictive "public interest" standard applies to *all* efforts to alter the contract rate—whether the purchaser challenges the rate as too high or the seller challenges the rate as too low. In *Potomac Electric*, 210 F.3d at

409, for example, the D.C. Circuit affirmed FERC's application of *Mobile-Sierra* public interest review to reject a complaint that the contract rate was too high. There, the customer had "fail[ed] to provide any evidence of undue discrimination or excessive burden, other than the disparity in rates and a bald claim that [the customer's] ratepayers would derive benefit from a rate modification." *Ibid.* Conversely, in *Boston Edison*, 233 F.3d at 68, the First Circuit vacated FERC orders that applied ordinary just and reasonable review in an action challenging a contract rate as too high. The court explained that FERC must employ *Mobile-Sierra* public interest review even where, "[a]dmittedly, the rates are too high for the period in question to be just and reasonable." Thus, the "flip side of" *Mobile*'s proposition "that purchasers can make bargains which in hindsight prove improvident . . . seems logically inferable," and "such a rule brings a certain symmetry to the ratemaking process." *Boston Edison*, 856 F.2d at 372. Hence, "[e]xcept as the exigencies of the public interest demand[]," FERC is "no more at liberty to alter the . . . contract to the prejudice of the [sellers] than to do so in their favor." *Pub. Serv. Comm'n of N.Y.* v. *FPC*, 543 F.2d 757, 798 (D.C. Cir. 1974).

In this case, the Ninth Circuit adopted the opposite approach. That court impermissibly rejected FERC's reliance on the three public interest factors set forth in *Sierra*—including whether the rate would impose an "excessive burden" on consumers, 350 U.S. at 355—*and* FERC's holding that California had failed to establish any other relevant public interest factor. Pet. App. 14a. That public interest test, the Ninth Circuit held, applies only where sellers challenge rates as too low, and not to cases where purchasers challenge rates as too high. *Ibid.* (holding that FERC had "relied on the wrong legal standard" by "appl[ying] factors taken from the context of a *low-rate* challenge rather than those relevant to [a] *high-rate* challenge"). Further substituting its discretion for FERC's expertise, the Ninth Circuit then announced its own test for so-called high-rate cases, holding that, in such cases, the interests of sellers and contract stability are subordinated, and "FERC must give *predominant weight* . . . to the impact of a challenged wholesale contract on the rates paid by the consuming public." *PUD*, Pet. App. 299a (emphasis added). The Ninth Circuit thus stated that consumers need not suffer the "excessive burden" described in *Sierra*. Rather, "if a challenged contract imposes *any significant cost* on ultimate consumers because [the] wholesale rate is *too high to be within the zone of reasonableness*, that contract affects the public interest." Pet. App. 15a (quoting *PUD*, Pet. App. 301a-302a) (emphasis added).

The Ninth Circuit's new requirement that FERC apply asymmetric standards to buyers and sellers doubly conflicts with decisions of the First and D.C. Circuits. First, the First and D.C. Circuits have held that FERC is "no more at liberty to alter" contracts "to the prejudice of producers than to do so in their favor." *Pub. Serv. Comm'n of N.Y.*, 543 F.2d at 798; p. 24, *supra*. The Ninth Circuit now has established precisely the opposite rule. Second, the Ninth Circuit's new "zone of reasonableness" test imposes the very standard those courts have rejected. To say that a rate is outside "the zone of reasonableness" is simply another way of saying that it is unjust and unreasonable. Indeed, the Ninth Circuit made it clear that its standard for high-rate cases was intended to "mirror" the standard "for determination of a just and reasonable rate." *Ibid.* The First and D.C. Circuits, however, have repeatedly held that lower standard to be patently inadequate under *Mobile-Sierra*. As the First Circuit observed when overturning a FERC decision that applied just and reasonable review to abrogate a high-rate contract: "The distinction between the 'just and reasonable' and 'public interest' standards loses its meaning entirely if the Commission can modify a contract under the public interest standard where it finds the contract 'may be unjust [or] unreasonable.'" *Northeast*

Utils. Serv. Co., 993 F.2d at 961. The D.C. Circuit cases are to the same effect. See, *e.g.*, *Atl. City*, 295 F.3d at 14.[12]

B. The Ninth Circuit's Rationale Is Unpersuasive

The Ninth Circuit's rationale does not withstand scrutiny. The regulatory system administered by FERC "is premised on contractual agreements" that should be abrogated "only in circumstances of unequivocal public necessity." *Permian Basin*, 390 U.S. at 822. "[P]reserving the integrity of contracts" under that standard "permits the stability of supply arrangements which all agree is essential to the health of the . . . industry." *Mobile*, 350 U.S. at 344. The central purpose of a fixed-price contract in the energy industry is to allocate the risk of highly volatile market prices. The Ninth Circuit's decision lowers the bar for buyers who bet wrong on a fixed price contract to abrogate that agreement midstream, while holding sellers to this Court's original, and exceptionally demanding, public interest standard for reforming contract prices. The Ninth Circuit nowhere attempted to reconcile its new, relaxed test for overturning contract rates claimed to be too high with the FPA's effort to achieve stability by preserving the integrity of contracts. That decision is particularly egregious here because FERC itself—the expert agency to which Congress delegated the FPA for administration—specifically invoked the need for market stability when refusing to overturn these very contracts: "[P]ower markets simply cannot attract the capital needed to build adequate generating infrastructure," FERC observed, without "regulatory certainty." Pet. App. 45a.

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[12] The Ninth Circuit cited three cases to support its claim that *Mobile-Sierra* public interest review applies only in cases of sellers' but not buyers' remorse: *Permian Basin*, 390 U.S. at 783-84, *Northeast Utils. Serv. Co.* v. *FERC*, 55 F.3d 686, 691 (1st Cir. 1995) ("*NUSCO II*"); and *Town of Norwood* v. *FERC*, 587 F.2d 1306, 1310 (D.C. Cir. 1978). In *Permian Basin*, however, this Court approved FERC's application of the *Sierra* public interest formulation where FERC modified existing contracts to impose both maximum and minimum rates. 390 U.S. at 782-84, 820-22 & n.113. The Court thus applied the public interest test to high-rate and low-rate claims alike. *NUSCO II* nowhere undermines the First Circuit's holding that high-rate cases brought by unhappy purchasers are governed by the same test as the low-rate claims in *Sierra*. To the contrary, in a "high-rate" case it enforced the First Circuit's earlier decision holding that FERC may not "conflate[] the 'just and reasonable' and 'public interest' standards, thereby circumventing the *Mobile-Sierra* doctrine." *NUSCO II*, 55 F.3d at 688 (quoting *NUSCO*, 993 F.2d at 961). And in *Norwood*, a customer claimed that its contract rate was too high *compared* to the contract rates of other customers of the same utility. Because undue discrimination is prohibited by FPA § 205(b) and is the third public interest factor in *Sierra*, the question there was whether those tests were identical. Agreeing with the Seventh Circuit and its own decisions, the D.C. Circuit held that they are not: "It is possible," that court held, "to have undue discrimination that violates § 205(b) but does not dismantle the protection generally afforded to fixed-rate contracts under *Mobile-Sierra*." *Norwood*, 587 F.2d at 1314 n.21 (quoting *Pub. Serv. Co. of Ind., Inc.* v. *FERC*, 575 F.2d 1204, 1213 (7th Cir. 1978)).

The Ninth Circuit's decision, moreover, rests on the unsubstantiated belief that buyers should be favored over sellers. But just two years after deciding *Mobile* and *Sierra*, this Court made it clear that the "public interest" encompasses the protection of sellers and buyers alike:

> Congress ... was not only expressing its conviction that the public interest requires the protection of consumers from excessive prices ... , *but was also manifesting its concern for the legitimate interests of the ... companies in whose financial stability the gas-consuming public has a vital stake....* This concern was surely a proper one for Congress to take into account in framing the regulatory scheme ... and we think that it did so ... by preserving the "integrity" of private contractual arrangements ....

United Gas Pipe Line Co. v. *Memphis Light, Gas & Water Div.*, 358 U.S. 103, 113-14 (1958) (emphasis added). The Court reiterated this point in *Permian Basin*, stating that "the Commission is permitted to give weight to the consequences upon producers, and thereby upon supply" even where "adjustments would increase the cost of natural gas to some groups of consumers." 390 U.S. at 822.[13]

This Court has previously rejected other Ninth Circuit efforts to gerrymander the Court's precedents to favor a set of claims it thought more deserving. This very Term, in *Weyerhaeuser Co.* v. *Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007), the Court reviewed a Ninth Circuit decision holding that this Court's two-part test for evaluating predatory pricing claims applies only to "sell-side predatory pricing" involving seller pricing alleged to be predatorily *low*, but not to buyer bids alleged to be predatorily *high*. *Id.* at 1073-74; *Confederated Tribes of Siletz Indians of Or.* v. *Weyerhaeuser*, 411 F.3d 1030, 1037-1038 (9th Cir. 2005). There, as here, the Ninth Circuit urged that "the concerns" arising from cases involving "low prices" are different from those involving high prices. 411 F.3d at 1038; Pet. App. 14a-15a. There, this Court rejected the Ninth Circuit's effort to skew the law based on its subjective view that different standards would be more beneficial to a particular group (consumers). *Weyerhaeuser*, 127 S. Ct. at 1077-78. The Court should do likewise here.

III. THESE IMPORTANT AND RECURRING ISSUES WARRANT IMMEDIATE REVIEW

The Ninth Circuit's decision effectively abrogates a critical, bedrock doctrine that has governed the energy industry since this Court articulated it 50 years ago. The electric industry is fundamental to virtually all economic activity in this country. It also is one of the most capital-intensive industries, and is on the front end of a huge infrastructure investment cycle. Over the next 15 years, the industry will need to invest an estimated $400 billion in new power plants and even more in other infrastructure. CERA, California Power Crisis Aftershock: The Potential Modification of Western Power Contracts, at 13-15 (2007), *available at* http://www2.cera.com/westernpowercontracts ("CERA Report"); Energy Policy Act of 2005, Pub. L. 109-58, § 1241, 119 Stat. 594, 961-62 (creating FPA § 219, 16 U.S.C. § 824s). If the Nation's need for power cannot be met, all economic activity will suffer.

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[13] The Ninth Circuit's decisions actually require FERC to focus on a *subset* of consumers: those consuming power purchased under the very contract at issue. Pet. App. 14a. That excludes future consumers in the same location, as well as other consumers in other locations—not to mention the interests of the seller, which may include not only its shareholders but other customers that may be adversely affected, and the industry as a whole.

Before the Ninth Circuit's decision, that massive investment could proceed solidly on the contractual certainty provided by the *Mobile-Sierra* doctrine. "By preserving the integrity of contracts," the doctrine "permits the stability of supply arrangements which all agree is essential to the health of the [energy] industry." *Mobile*, 350 U.S. at 344. With the advent of competitive bulk power markets, *Mobile-Sierra* has become even more critical. "The certainty and stability which stems from contract performance and enforcement is essential to an orderly bulk power market. If the integrity of contracts is undermined, business would be transacted without legally enforceable assurances and we believe that the market, the industry and ultimately the consumer would suffer." *San Diego Gas & Elec. Co.*, 904 F.2d at 730.

The impact of the Ninth Circuit's decision on *Mobile-Sierra*—and consequently on industry health—is enormous. The Ninth Circuit held that *Mobile-Sierra* does not apply to contracts that FERC accepts for filing because FERC has not approved them. But that is true of virtually every contract, including the contracts at issue in *Mobile* and *Sierra*. And the Ninth Circuit's "one way street" view of the public interest standard—under which purchasers can challenge rates more readily than sellers—threatens serious destabilizing effects. It creates additional risk for sellers and undermines the stability FERC itself invoked when refusing to upset the contract rates at issue here. In the long run, that increased risk will cause increased prices. CERA Report at 22.

The disuniformity in Circuit law created by the Ninth Circuit's decision is particularly intolerable. FERC's orders may always be appealed to the D.C. Circuit, to the Circuit where the complainant resides, or to the Circuit in which the transaction occurred. 16 U.S.C. § 825*l*(b). As a result, the sharp conflict between the Ninth Circuit's approach on the one hand and that of the First and D.C. Circuits on the other will make it nearly impossible for FERC to gauge the proper standard. More important, it means that the outcome of any litigation will largely depend on the happenstance of where that challenge is brought or—in the case of challenges in multiple jurisdictions—where it ends up. See 28 U.S.C. § 2112(a)(3). The Court should grant the petition to restore uniformity to Circuit law and restore the certainty and predictability of contract enforcement in this important area of law.

CONCLUSION

The petition for a writ of certiorari should be granted. In the alternative, the Court may wish to consider summary reversal.

Respectfully submitted.

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May 3, 2007

APPENDIX

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Nos. 03-74207, 03-74246

Public Utilities Commission of the State of
California; California Electric Oversight Board,

Petitioners,

Pacific Gas and Electric Company; Nevada Power
Company; Southern California Edison Co. DISON
Department of Water and Power of the City of Los
Angeles, Public Service Department of the City of
Burbank, Public Service Department of the City of
Glendale, and Water and Power Department of the
City of Pasadena (Collectively ET AL
Sempra Energy; Mirant Americas Energy Marketing,
L.P.; Coral Power; PPM Energy; Public Utility
District No. 1 of Snohomish County, Washington;
Dynegy Power Marketing Inc.,

Intervenors,

v.

Federal Energy Regulatory Commission,

Respondent.

California Electric Oversight Board;
California Public Utilities Commission,

Petitioners,

Nevada Power Company; Southern California Edison
Co. DISON Department of Water and Power of

THE CITY OF LOS ANGELES, PUBLIC SERVICE DEPARTMENT
OF THE CITY OF BURBANK, PUBLIC SERVICE DEPARTMENT
OF THE CITY OF GLENDALE, AND WATER AND POWER
DEPARTMENT OF THE CITY OF PASADENA (COLLECTIVELY
ET AL SEMPRA ENERGY; MIRANT AMERICAS
ENERGY MARKETING, L.P.; PPM ENERGY; PUBLIC UTILITY
DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON;
DYNEGY POWER MARKETING INC.,

INTERVENORS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

RESPONDENT.

APPEAL FROM THE FEDERAL ENERGY
REGULATORY COMMISSION (FERC)

Argued and Submitted Dec. 8, 2004
Filed Dec. 19, 2006

Before BROWNING, PREGERSON, and BERZON, Circuit Judges.

BERZON, Circuit Judge.

As in *Public Utility District No. 1 v. FERC ("PUD")*, Nos. 03-72511, et al. (9th Cir. Dec. __, 2006), a related case also decided today, the peti
Public Utilities Commission ("PUC") and the California

electric power rates in certain wholesale power contracts. Again as in *PUD*, that challenge hinges on whether the Federal Energy Regulatory

correct to apply the *Mobile-Sierra*[1]
doctrine or whether in doing so it failed to meet its statu-
ust and reasonable" review. *See*
16 U.S.C. § 824e(a).

In *PUD*, we explained that *Mobile-Sierra* represents a

tract over a designated period of time, lawful under the
PUD, Slip Op. at 19554.

ing that the contract adversely
Id., Slip Op. at 19554. We concluded that, to establish the *Mobile-Sierra* presumption, "three prerequisites are necessary: (1) the contract by its own terms must not preclude the limited *Mobile-Sierra* review; (2) the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for effective, timely review of the contracted rates; and (3) where, as here, FERC is relying on a market-based rate-setting system to produce just and reasonable rates, this review must permit consideration of all factors relevant to the propriety of the contract's formation." *Id.*, Slip Op. at 19555-56. In *PUD* we found two of these prerequisites lacking and remanded to FERC for it to consider the propriety of applying the *Mobile-Sierra* mode of review to the contracts at issue. We held, in the alternative, that even if *Mobile-Sierra*
that the challenged contracts do not affect the public interest was based on a substantively erroneous mode of analy-
Id., Slip Op. at 19549.

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[1] This shorthand takes its name from two Supreme Court cases decided on the same day: *United Gas Pipe Line Co. v. Mobile Gas Service Corp. (Mobile)*, 350 U.S. 332, 76 S. Ct. 373, 100 L. Ed. 373 (1956), and *Federal Power Commission v. Sierra Pacific Power Co. (Sierra)*, 350 U.S. 348, 76 S. Ct. 368, 100 L. Ed. 388 (1956).

Applying *PUD* to the challenged contracts in this case, we grant the petition to review and remand to the agency to apply the modes of review outlined in *PUD*.

I.

Much of the relevant background to this case is described in *PUD*. *See id.*, Slip Op. at 19567-83. We therefore will summarize only those facts relevant to the present case.

A. California Energy Crisis

California responded to the energy crisis outlined in *PUD* in several ways, although

ered on insolvency. Governor Gray Davis declared a state of emergency on January 17, 2001, and ordered the California Department of Water Resources ("CDWR") to purchase forward power "as expe-

Legislature passed Assembly Bill 1 of the 2001-2002 First Extraordinary Session ("AB1X"), which authorized CDWR to purchase power through the end of December 31, 2002.

Between February 6 and August 23, 2001, CDWR executed 57 forward contracts with 28 suppliers. Some of these contracts explicitly called for applying the relatively stringent *Mobile-Sierra*

relatively relaxed "just and

rates included in the contracts. Other contracts were silent regarding the test to apply. The 57 contracts include 32 agreements with the intervenor-respondents in this case:[2]

delivery in 2001 and 2002;

- Dynegy Power Marketing, Inc., for $119.50/MWh, for delivery from January 1, 2002 through December 31, 2004;

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[2] These energy companies are all intervenors on behalf of FERC in this case.

MWh, for delivery between June 1, 2001 and December 31, 2002;

- PacifiCorp ("PPM"), for $70/MWh, for delivery between July 29, 2001 and June 30, 2002; and

very between June 1, 2001 and September 30, 2001.

Under AB1X, the people of California must pay the cost of these contracts through their electricity rates. *See* CAL. WATER CODE

to them, the retail end use customers shall be deemed to have purchased that power from the department. Payment for any sale shall be a direct obligation of the retail end use customer to the department."). Raymond Hart, who testified for the Public Utilities Commission, described this statutory provision as ensuring that costs of CDWR contracts

etail end-users of the IOUs [investor-owned utilities] through their retail electricity

power it purchased to local utilities—such as Pacific Gas

ssed it on to California consumers. FERC questions whether the challenged contracts call for rates above long-run competitive prices, *Pub. Utils.*

, 103 F.E.R.C. ¶ 61,354, at ¶ 62,415 (2003), but does not contest that the cost of those contracts is passed on to California consumers.

On June 19, 2001, FERC issued a price mitigation order for spot markets regarding several western states, which went into effect the following day. Subsequently, prices generally returned to pre-crisis levels in both spot and forward markets, completing a downward cycle that had begun about a month prior to the June 19 Order.

B. Procedural Background

On February 25, 2002, PUC filed complaints under section 206(a) of the Federal Power Act,[3] 16 U.S.C. § 824e(a), seeking modification of all power contracts signed by CDWR in 2001.[4] The only contracts at issue on this appeal are those listed above, which PUC alleges overcharge CDWR and California consumers by a total of $1.4 billion. In the process of adjudicating and ultimately denying these complaints, FERC issued a series of orders:

On April 25, 2002, FERC ordered a hearing to determine "whether the dysfunctional California spot markets adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue *Pub. Utils. Comm'n v. Sellers of Long Term Contracts*, 99 F.E.R.C. ¶ 61,087, at ¶ 61,384 (2002) (footnote omitted). FERC announced that it would review all contracts explicitly calling under *Mobile-Sierra*,[5] while setting for hearing the question of whether it would also apply that standard to contracts that were silent on the issue.[6] *Id.* ¶ 61,383. FERC dismissed the complaints with regard to all contracts executed on or after June 20, 2001, the date its final price mitigation order went into effect, including the CDWR contract with PPM, which had been negotiated before but signed after that date. Finally, the April 25 order held that both the

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[3] Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affect such rate, charge, or classification is *unjust*, *unreasonable*, unduly discriminatory or preferential, the Commission shall determine the *just and reasonable* rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

16 U.S.C. § 824e(a) (emphases added).

[4] Much of the parties' disagreement hinges on whether the identity of the parties—state agencies other than those that entered into the challenged agreements—affects the application of *Mobile-Sierra* to those agreements. As we decide, applying *PUD*, that FERC erred for other reasons by applying *Mobile-Sierra*, we need not reach the question of the impact of the parties' identity.

[5] These included the Coral and Mirant contracts.

is not a party in this case, because they are all state agencies. *Id.* ¶ 61,382. Accordingly, the petitioners would both be treated as if they were the same entity as CDWR. *Id.*

Before the Administrative Law Judge ("ALJ"), PUC

market power in the spot markets. The ALJ denied this request, reasoning that "the hearing order in this case takes as a given the proposition that the California spot markets

ally, the ALJ excluded some

evidence, in the form of tes

nesses, that related to the se

ward markets.

At the conclusion of the ALJ's hearing, FERC created a two-track process. For contracts that had explicit provi-

the ALJ not to rule on those cases and instead to certify the record directly to the Commission. For the other contracts, the ALJ was directed to decide only whether the parties intended the public interest test to apply. *Pub. Utils.*

, 101 F.E.R.C.

¶ 61,293, at ¶ 62,173 (2002).

On February 10, 2003, FERC, on remand from this court,

, Order of August 21, 2002, (9th Cir. Docket Nos. 01-71051, et al.), issued an order in a separate case relating to spot market

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[6] These included the Dynegy, Sempra, and PPM contracts.

manipulation, permitting discovery for over 100 days regarding such manipulation and requiring parties in that case to provide an index of
other pending or proposed proc
request. *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 102 F.E.R.C. ¶ 61,164, at ¶ 61,446 (2003).

tional evidence regarding sellers' spot market manipulation.

TAFF OF THE FEDERAL ENERGY REGULATORY COMMISSION, FINAL REPORT ON PRICE MANIPULATION IN WESTERN MARKETS: FACT-FINDING INVESTIGATION OF POTENTIAL MANIPULATION OF ELECTRIC AND NATURAL GAS PRICES
available at http: //www.ferc.gov/legal/maj-ord-reg/land-docs/PART–I–3–26–03.pdf [Staff Report]. The Staff Report concluded that the spot market dysfunc-

kets. *Id.* at V–12.

FERC issued an initial decision on June 26, 2003,
, 103
F.E.R.C. ¶ 61,354 (2003). Most importantly, FERC con-

contracts at issue, upholding the ALJ's opinion that parties to all contracts intended to trigger that test. *Id.* ¶ 62,409.

effect on forward markets—the very issue FERC initially deemed to be the purpose of

Id. ¶ 62,415. "Under the 'public interest' standard, to justify contract modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms and conditions are contrary to the public

[7] *Id.* Further, FERC concluded that PUC failed to satisfy any of the three prongs of the public interest test established by Supreme Court precedent (described below) *Id.* FERC found "no credible record evidence that the contracts at issue are placing Complainants in financial dis- *Id.* FERC based this conclusion on a comparison of

age price no higher than $70/MWh which averaged a price of $84/MWh for 2001-2005. *Id.* Commissioner Massey dissented, calling application of the opriate. Commissioner Massey also concluded that PUC proved a strong "nexus between the California spot market and the forward contract mar- the just and reasonable and public interest standards for contract reformation. *Id.*

FERC denied rehearing on November 10, 2003. *Pub. Utils. Comm'n v. Sellers of Long Term Contracts*, 105 F.E.R.C. ¶ 61,182 (2003). One week later, PUC and CEOB filed petitions for review with this court.

C. Standard of Review

Am. Rivers v. FERC of a FERC decision is limited to whether the decision was arbitrary, capricious, an abuse of discretion, unsupported by substantial evidence, or not in accordance with the law." , 341 F.3d 906, 910 (9th Cir. 2003); *see also* 5 U.S.C. § 706(2)(A). The court reviews factual findings for substantial evidence, 16 U.S.C. § 825l (b), and will uphold them so long as the agency considered all relevant factors and did not make a clear error of judgment, *Cal. Dep't of Water Res.*, 341 F.3d at 906. When an agency makes an informed choice to rely on one expert opinion among competing expert opinions, the agency is entitled to deference. *Bear Lake Watch, Inc. v. FERC*, 324

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[7] This language appears verbatim in FERC's *PUD* orders. *See Nev. Power Co. v. Enron Power Mktg., Inc.*, 103 F.E.R.C. ¶ 61,353, at ¶ 61,397 (2003).

to justify deviations from an approach suggested by its own staff" unless "the conceptual underpinnings of the staff's approach [are] critical to a reasoned resolution of the prob-

dations. *Pub. Utils. Comm'n v. FERC*, 817 F.2d 858, 862 (D.C. Cir. 1987).

II.

Application of Mobile-Sierra

We hold in *PUD*, decided today, that FERC may apply the *Mobile-Sierra* of review only if three conditions are present:

terms must not preclude the limited *Mobile-Sierra* review; (2) the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for effective, timely review of the contracted rates; and (3) where, as here, FERC is relying on a market-based rate-setting system to produce just and reasonable rates, this review must permit consideration of all factors relevant to the propriety of the contract's formation." *PUD*, Slip Op. at 19555-56. Here, it is undisputed that the contracts at issue either explicitly call for *Mobile-Sierra* review or do not preclude it. *Cf. PUD*, Slip Op. at 19589-93. Thus, resolution of the present case turns on whether the second two *Mobile-Sierra* prerequi-

presumption of just and reasonable rates.

1. *Timely and Effective Review of Rates*

In *PUD*

thority *can* qualify as sufficient prior review to justify limited *Mobile-Sierra* review, it can only do so when accompanied by effective oversight permitting timely reconsideration of market-based authorization if market con-

Id., Slip Op. at 19593. Here, as in *PUD*,

precludes timely consideration of sudden market changes and offers no protection to purchasers victimized by the abuses of sellers or dysfunctional market conditions that

Id., Slip Op. at 19603.

Energy company intervenors and amici argue here, as FERC did in *PUD*, that petitioners or CDWR should have

based rate authority before entering into the forward contracts, rather than agree to and subsequently challenge the contracts. This argument fails for the same reasons it failed in PUD. *See id.*, Slip Op.

e, even if successful, could not have been a basis for reforming the challenged con-

Dynegy raises an argument unique to its contract, which it did file with FERC, effective March 6, 2001, and which FERC opened to the public for comments.[8] *Dynegy Power Mktg., Inc.*, 95 F.E.R.C. ¶ 61,371 (2001). Dynegy asserts that PUC had an opportunity, during the public comment period, to raise a substantive challenge to this contract but declined to do so.

Nothing about this circumstance, however, justifies a contrary result from that reached with regard to all the other contracts. FERC explicitly noted that accepting the filing of the Dynegy contract did "not constitute approval of any . . . rate . . . ; and such action is without prejudice to any findings or orders which . . . may hereafter be made by the Commission in any proceeding now pending or hereafter instituted by or against Dynegy." *Id.* ¶ 62,401. FERC, therefore, did not give prior approval to the Dynegy contract any more than it did for any of the other contracts challenged here. Further, any challenge to the contract at the time FERC sought public comments would have been hampered by limited information: At the time Dynegy filed its contract, the full scale of spot market manipulation and forward market dysfunction was not nearly as fully known as it is today.

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[8] Dynegy's argument on this point refers only to the prior review prerequisite to application of *Mobile-Sierra*. Even if its argument succeeded on this point, it would not be sufficient to overcome the other portions of our opinion which provide independent reasons for granting PUC's petition for review.

For these reasons, we hold here that FERC "cannot use [its] choice [of regulatory regime] to excuse its duty to maintain effective oversight [of rates] and then invoke *Mobile-Sierra* as a ground for precluding ordinary rate review, including review of the propriety of market-based rate

PUD, Slip Op. at 19603.

2. *Meaningful Review of Contract Formation*

Even if the agency had no

mental procedural error[,] . . . FERC's substantive adherence to *Mobile-Sierra* without regard to the market condi-

error. *Id.*, Slip Op. at 19604. In particular, FERC refused to consider evidence of forward market dysfunction caused by the spot market, asserting that such evidence was not

, 103 F.E.R.C. at ¶ 62,415. Because *Mobile-Sierra* cannot apply without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional

PUD

"public interest" mode of review here was improper.

As in *PUD*, FERC failed to respond to the Staff Report. *See PUD*, Slip Op. at 19604-06. Rather than consider its discussion of the dysfunction in the forward market, FERC

sions as only relevant if it was *first* determined that just and reasonable review is applicable, the same way it treated other evidence of market dysfunction. *Pub. Utils. Comm'n*, 103 F.E.R.C. at ¶ 62,415 & n.38. This was error. *See PUD*, Slip Op. at

ed by the Staff Report— whether and how the manipulated spot market influenced

are relevant to determining whether the *Mobile-Sierra* doctrine applies, because, they raise questions about the market conditions at the time of contract formation and thus about the propriety of relying on a regime of market-based rate authority at that time to

PUC's other evidence—including testimony of expert wit-

on forward prices. As *PUD* makes clear, such evidence is essential to the question of whether the forward energy market was sufficiently well-functioning to apply *Mobile-Sierra. See id.*, Slip Op. at 19605-06.

On remand, FERC should consider the excluded evi-

of the "100 Day Proceeding" or not—before determining whether the *Mobile-Sierra* presumption applies.

3.

Consistent with *PUD*

deciding *whether* to apply the *Mobile-Sierra* presumption was compounded by it use of an erroneous standard for determining whether the challenged contracts affect the

Id., Slip Op. at 19606-07. "In its efforts to determine the impact on the public interest under *Mobile-Sierra* . . . FERC relied on the wrong legal standard, applying factors taken from the context of a *low-rate* challenge rather than those relevant to the *high-rate* challenge pre- *Id.*, Slip Op. at 19607.

FERC determined that the challenged contracts in this case did not affect the public interest because PUC:

> presented very little evidence relevant to the *Mobile-Sierra* standard of review. Based on the record, we conclude that Complainants have failed to demonstrate that any of the three prongs announced in the *Sierra* case has been met or that any other factor introduced into evidence warrants a finding that any of the contracts is contrary to the public interest and should be modified.[9]

, 103 F.E.R.C. at ¶ 62,415. FERC determined that because consumers did not face an "excessive *any* burden was inapposite. , 105 F.E.R.C. 61,182, at ¶¶ 66-67. As we explained in *PUD*, this determination fundamentally misunderstands the public interest inquiry in the context of a high-rate challenge. *See PUD*, Slip Op. at 19607-11.

Under California law, all costs of the challenged contracts were passed on to consumers. *See* CAL. WATER CODE § 80104. The parties debate whether retail power rates in fact increased after the parties signed these contracts, but this dispute is not determinative. Even if rates did not increase in the months after CDWR signed the contracts, the retail rates charged consumers because of these

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[9] In such circumstances [when the public interest test satisfies the Commission's duty to ensure just and reasonable rates] the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.

Sierra, 350 U.S. at 355, 76 S. Ct. 368.

contracts might have been higher than they would have been had the wholesale contract rates been lower. *See* *PUD*
any significant cost on ultimate customers because of a wholesale rate too high to be within a zone of reasonableness, that contract affects
omitted)).

III.

Finally, we grant PUC's petition as it relates to FERC's

iss the case against the PPM contract without a hearing may be affirmed only if FERC
in dispute and . . . a formal hearing was unnecessary for the Commission to reach its conclusion." *Pac. Gas & Elec. Co. v. FERC,* 746 F.2d 1383, 1386 (9th Cir. 1984). We believe FERC failed to address all relevant factors here.

FERC dismissed the PPM challenge because the parties entered the contract af
, 99 F.E.R.C. ¶ 61,087, at ¶¶ 61,383-84 (2002). FERC did not consider, however, whether some market dysfunction may have lingered after that order took effect. PPM, intervening in this case, argues that the chronology of its contract factually distinguishes it from the other challenged contracts. We disagree.

It is not at all clear that the forward markets had stabilized by the date when the parties entered the PPM contract. On the contrary, FE

a persistence of the effects found during the crisis, i.e., statistically significant positive elasticities of the forward

While the Staff Report qualified its conclusion regarding post-June 19 effects of mark fect from the spot markets than pre-June 19 contracts, FERC should have at least considered the possibility that ill effects remained. Therefore, the agency's dismissal of the challenge was inappropriate.

IV.

For the foregoing reasons, we determine that a remand is necessary so that FERC can apply the proper statutory standards to determine, first, whether *Mobile-Sierra* review of the challenged contracts is appropriate; second, if so, to apply the modified form of *Mobile-Sierra* review outlined in *PUD* and referenced in this opinion; and finally, if not, to apply full just and reasonable review to the challenged contracts.

PETITION FOR REVIEW GRANTED AND REMANDED.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[¶ 61,182]

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

v.

SELLERS OF LONG TERM CONTRACTS TO THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

DOCKET NOS. EL02-60-000, EL02-60-003
AND EL02-60-004

CALIFORNIA ELECTRICITY OVERSIGHT BOARD

v.

SELLERS OF ENERGY AND CAPACITY UNDER LONG-TERM CONTRACTS WITH THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

DOCKET NOS. EL02-62-000, EL02-62-003
AND EL02-62-004

(CONSOLIDATED)

ORDER ON REHEARING AND CLARIFICATION

(Issued November 10, 2003)

Before Commissioners: Pat Woods, III, Chairman; William L. Massey, and Nora Mead Brownell.

1. On February 25, 2002, the Public Utilities Commission of the State of California (CPUC) and the California

plainants") filed complaints seeking to modify certain long-term contracts entered into between the California Department of Water Resources (CDWR) and more than twenty-four (24) sellers.[1] As a result of withdrawals and dismissals, only four sellers remain in this proceeding.[2] They are Mirant America Energy Marketing, LP (Mirant); Coral Power, L.L.C. (Coral); Dynegy Power Marketing, Inc.

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[1] *See Public Utilities Commission of California v. Sellers of Long Term Contracts*, 103 FERC ¶ 61,354 n.21 (June 26 Order).

[2] *Id.* We also granted withdrawal of the complaints as to *Allegheny Energy Supply Company, LLC (Allegheny)* on July 11, 2003. *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 104 FERC ¶ 61,074 (2003).

On August 6, 2003, Complainants moved to dismiss with prejudice their complaints against El Paso Merchant Energy, L.P. (El Paso) as Complainants and El Paso have reached a comprehensive settlement (Master Settlement Agreement) resolving Complainants' claims against El Paso in this proceeding. Complainants further request that the dismissal be void *ab initio* if the Effective Date under the Master Settlement Agreement never occurs. We grant Complainants' motion and dismiss their complaints as to El Paso with prejudice. *See also* Rule 216 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.216 (2003). This dismissal will be void *ab initio* if the Effective Date under the Master Settlement Agreement never occurs.

On September 25, 2003, Complainants moved to withdraw with prejudice their complaints as to Morgan Stanley Capital Group, Inc. Consistent with Rule 216 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.216 (2003), the withdrawal has become effective by operation of law.

On April 25, 2002, we dismissed the complaints as to contracts entered into after June 20, 2001. *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 99 FERC ¶ 61,087, at pp. 61,383-84 (April 25 Order), , 100 FERC ¶ 61,098 (2002) (July 23 Order).

(Dynegy); and Sempra Energy Resources (Sempra). The complaints allege that the prices, terms and conditions of the contracts are unjust and unreasonable and, to the extent applicable, not in the public interest, and that the respondents obtained the prices, terms and conditions in the contracts through the exercise of market power in violation of the Federal Power Act (FPA).

2. On June 26, 2003, we denied the complaints.[3] In this Order, we deny the requests for rehearing, reaffirm our conclusion that the record in this proceeding does not support modification of the contracts at issue for the reasons stated below, and address the request for clarification. This Order is in the public interest because it balances effective rate regulation with respect for the sanctity of contracts, as dictated by the U.S. Supreme Court under the *Mobile-Sierra*[4] doctrine.

I. Background

3. In the April 25 Order, we found that the Mirant and Coral contracts contained explicit provisions limiting the

205 or Section 206 filings, as well as the FPA Section 206 rights of third parties, to amend the contract, and, therefore, Complainants would have to satisfy the public interest standard of review set out in *Mobile-Sierra* to justify the requested contract modification.[5]

4. As for the contracts that did not contain explicit *Mobile-Sierra* provisions (the Dynegy and Sempra contracts), we found the record was insufficient to determine whether Complainants would face a *Mobile-Sierra* burden

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[3] June 26 Order, 103 FERC ¶ 61,354.

[4] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (*Mobile*); *FPC v. Sierra Pacific Power*, 350 U.S. 348 (1956) (*Sierra*).

[5] April 25 Order, 99 FERC at p. 61,383.

of proof or the FPA Section 206 just and reasonable burden of proof to justify modification.[6] Thus, we "set for hearing the issue of whether the complainants must bear the burden of showing that [the Dynegy or Sempra] contract[s] [are] contrary to the public interest, or whether they will bear the burden of showing that the contract[s] [are] not just and
[7]

5. We also set for hearing, as to the Mirant, Coral,

er the dysfunctional California spot markets adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue is war-
[8] If the administrative law judge (ALJ) were to conclude that modification of one or more of the contracts was warranted, she was not to determine how those contracts should be modified.[9]
established to, among other things, interpret the terms of [the contracts at issue] and to ascertain the intent of the
[10]

6. On December 17, 2002, we directed the ALJ to omit the initial decision as to contracts containing explicit *Mobile-Sierra* provisions and to certify the record as to those contracts directly to the Commission.[11] Then, on Jan-

which standard of review applies to the contracts not containing explicit *Mobile-Sierra*

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[6] *Id.*

[7] *Id.*

[8] *Id.* at p. 61,384 (footnote omitted).

[9] *Id.*

[10] July 23 Order at p. 61,393.

[11] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 101 FERC ¶ 61,293 (2002).

[a]s to the contracts for which the Presiding ALJ

the ALJ should then address the question of wheth

which the Presiding ALJ determines that the ap-

standard, the ALJ should certify the record directly to the Commission. The Commission will then deter-

met.[12]

7. On January 16, 2003, after holding an evidentiary hearing held on December 2-12, 2002, the ALJ issued an initial decision on the limited burden of proof/standard of review issue we directed and certified the record to us for determination of all remaining issues.[13] The ALJ found that

e evidence presented at the hearing persuasively demonstrated that the contracting parties did not, nor did they intend to, preserve their rights to make unilateral application to the Commission for modification of the contracts.[14]

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[12] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 102 FERC ¶ 61,025 at P 13 (2003).

[13] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 102 FERC ¶ 63,013 (2003) (Partial Initial Decision).

[14] *Id.* at P 43 (*citing, e.g.*, Exh. SER-1 at 34:6-26, 34:10-26 (Niggli); Exh. SER-32 at 6:17-28 (Niggli); Exh. DYN-1 at 33:10-34:5 (Lednicky)); *id.* at P 45. The ALJ noted that "the extrinsic evidence of record indicate[d] that the State had very little confidence in the Commission as an avenue for relief at the time these contracts were negotiated, that CDWR negotiated the subject contracts in a 'crisis' environment, and that for various reasons CDWR's negotiating team focused almost exclusively on the pricing terms of the subject contracts. In fact, at least one witness testified that precluding unilateral application to the Commission for changes in rates, terms and conditions was an issue of importance to CDWR and that the parties agreed to language to this effect in their executed contract." *Id.* at P 43.

Dynegy Contract

8. The ALJ explained that, while the Dynegy contract did not contain a provision specifically addressing the parties' FPA Section 205 or Section 206 rights, a provision in a subpart of the contract (Section 8, paragraph F of the System Contingent Capacity Purchase and Sales Agreement) "appears to limit CDWR's right to take any action which is inconsistent with the just and reasonable nature of

[15] That section provides that:

> CDWR acknowledges and agrees that all payments to
>
> within the meaning of Section 451 of the Public Utilities Code and that CDWR shall not take any action or fail to take any action which is inconsistent with the just and reasonable nature of such payments.[16]

insisted on this provision, otherwise Dynegy would not have had any assurance of payment and no assurance that CDWR would not later seek to devise a way to abrogate the

[17] That same witness asserted that "any argument advanced by, or on behalf of CDWR, that the FERC can or should review and determine whether the Agreement, or payments under the Agreement are 'just and

just and reasonable nature
pressly prohibited by the Agreement."[18]

determination regarding whether a rate is just and reasonable is not governed by Section 451 of the Public Utilities
ction 8, paragraph F of the

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[15] *Id.* at P 37.

[16] *Id.* (*quoting* Exh. DYN-2 at EOB-DYN-1-0005286).

[17] *Id.* (*citing* Exh. DYN-1 at 33:6-9).

[18] *Id.* (*quoting* Exh. DYN-1 at 33:15-34:[illegible]).

System Contingent Capacity Purchase and Sales Agreement:

> suggest[s] that the parties agreed that they would not take any action which is inconsistent with the presumed just and reasonable nature of the rates in this contract. Accordingly, and because the contract is
>
> 205 and 206 rights, . . . the *Mobile-Sierra* 'public
> applied in this instance.[19]

Sempra Contract

11. The ALJ found that one provision in the Sempra

205 and 206:[20]

> FERC. The Parties acknowledge that (i) this agreement provides for wholesale power sales subject to the jurisdiction of the FERC under the FPA; and (ii) the rates, terms and conditions of this Agreement are 'just' and 'reasonable' within the meaning of the FPA and that changes in market conditions will not render such rates, terms and condit
> able' for purposes of Section 206 of the FPA.[21]

12. The ALJ further noted th
witness that, initially, Sempra proposed contract language that would give both CDWR and Sempra the unilateral right to seek contract modification, but, because CDWR did not want FERC to have the ability to review the rates, terms and conditions of the contract, they agreed to alter the contract to limit the unilateral right of either Sempra or CDWR to modify the contract's rates, terms or conditions of service.[22] Based on the contract language quoted above

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[19] *Id.* at P 38 (*citing* Exh. S-4 at 10:15-12:10); *see id.* at P 43.

[20] *Id.* at P 41 (*citing* Section 10:03 of the Energy Purchase Agreement).

[21] *Id.*

[22] *Id.* at P 42 (*citing* Exh. SER-1 at 34:10-26).

and the cited witness testimony, the ALJ concluded that the *Mobile-Sierra* public interest standard applies to the Sempra contract.[23]

13. In addition, the ALJ note
that they:

> have not argued, or submitted evidence, to the effect that the absence of an explicit *Mobile-Sierra* provision in the [Dynegy and Sempra] contracts is itself a basis for not applying the *Mobile-Sierra* standard to those contracts. Accordingly, to the extent the *Mobile-Sierra* standard applies to the contracts with explicit *Mobile-Sierra* provisions, it applies to the contracts without such provisions.[24]

14. The ALJ further explained the basis of her determination that unilaterally proposed changes to the Dynegy and Sempra contracts are subject to review under the *Mobile-Sierra* public interest standard.[25]

> As here, where the contract has not reserved the rights of a party to seek unilateral modifications, the finding that the *Mobile-Sierra* standard of review applies to a negotiated contract unless the contract expressly states otherwise serves to protect the expectations of contracting parties that their negotiated agreement will be respected, thus promoting stability of contracts, stability of the market as a whole, and protecting ratepayers by encouraging the utilization of contracts to reduce reliance on the more costly and

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[23] *Id.* at P 42 (*citing* Exh. S-4 at 15:14), P 43, P 45.

[24] *Id.* at P 44 (*quoting* Complainants' January 14, 2003 Answer to Motion to Hold Briefing in Abeyance).

[25] *Id.* at P 43.

afforded to consumers under the FPA.[26]

15. The parties submitted initial trial and reply briefs as well as briefs on exceptions to the Initial Decision and oppositions thereto. Also, on May 15, 2003, we held oral argument.

the public interest standard of review applies to all the contracts at issue without explicit *Mobile-Sierra* language.[27] In doing so, we explained the genesis and parameters of the *Mobile-Sierra* doctrine, its public interest standard, and their impact on our review of requests for contract modification.[28] As we explained, the *Mobile-Sierra* cases and their progeny hold that, where parties contract for a particular rate and do not reserve their rights to unilaterally propose a rate change, a party cannot unilaterally file for a new rate and the Commission cannot act under the FPA just and reasonable standard to supersede the contractually agreed-upon rate.[29] Rather, we can grant a unilateral request to alter a contract under which the requesting party did not reserve its rights to unilaterally propose a rate change only if the proposed change is required by the

17. We also denied the complaints, finding that Complainants did not meet their burden of proof under the public interest standard to justify modifying any of the con-

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[26] *Id.* at P 45 (*citing Texaco Inc. v. FERC*, 148 F.3d 1091, 1095 (D.C. Cir. 1998) (*Texaco*); *Town of Norwood v. FERC*, 202 F.3d 392, 400 (1st Cir. 2000); *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 953 (D.C. Cir. 1983) (*Papago*)).

[27] June 26 Order, 103 FERC at P 3.

[28] *Id.* at P 4-7.

[29] *Id.* at P 4 (*citing Boston Edison Co. v. FERC*, 233 F.3d 60, 64-65 (1st. Cir. 2000)).

tracts still at issue in this proceeding.[30] Based upon our review of the evidentiary record developed in this Report on Price Manipulation in Western Markets in Docket No. PA02-2-000 (Staff Report), evidence submitted in the 100-Day Discovery Proceeding in Docket No. EL00-95, *et al.*, and the totality of the circumstances, we concluded that the Complainants failed to meet their burden of proof under the public interest standard of review.[31] As Complainants devoted most of the evidentiary hearing and briefing to attempting to demonstrate that the contracts were unjust and unreasonable, we found that they presented very little evidence relevant to the *Mobile-Sierra* public interest standard that applies here.[32] We also found that the Complainants failed to demonstrate that the contracts in question caused financial distress for the Complainants (or others they represent), threatening their ability to continue service; that the contracts cast an excessive burden on customers; that the contracts were unduly discriminatory; or any other factors showing that modifying the contracts is required by the public interest.[33]

18. For example, we found that, through these contracts, CDWR achieved one of its central objectives of having a portfolio that yields a weighted average price no higher than $70/MWh, the average cost of energy supply reflected in IOUs' retail rates, as of January 2001.[34] In

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[30] *Id.* at P 3.

[31] *Id.* at P 3, 8.

[32] *Id.* at P 39.

[33] *Id.* at P 8, 39.

[34] *Id.* at P 40 (*citing* Exh. CAL-51 at 10:24-11:3; Exh. AYE/SER-7 at 70:22-71:4 (Hart deposition); Exh. AYE/SER-11 at 64:11-66:2 (Nichols deposition); Tr. at 1258:14-1260:9; Exh. S-8 at 16:2-23; Exh. CAL-70 at 13 of Update of California Department of Water Resources Power Purchase Contract Efforts dated May 31, 2001 (May 31, 2001 CDWR Update); Exh. CAL-51 at 31:16-19; Exh. DYN-1 at 16:25-27).

securing its contracts, CDWR also achieved an overall portfolio that is diversified both in terms of energy products and durations.[35] Furthermore, the evidence did not show that the contracts were priced above long-run competitive prices.[36] Nor did Complainants present evidence to support a finding that the contracts are unduly discriminatory or preferential to the detriment of other purchasers who are not parties to the contract.[37]

19. We further found that the extensive evidentiary record regarding the totality of circumstances preceding and following the execution of the contracts at issue shows that CDWR had options and at least some bargaining power when it entered into this portfolio of contracts after often protracted negotiations.[38] When the contracts were executed, alternatives were available; the parties voluntarily chose to enter into the contracts, accepting market risks.[39]

20. Additionally, we found nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation *specific to* the long-term contract negotiations resulting in the prices and terms challenged here.[40] There was no evidence to support a finding of unfairness, bad faith, or duress in the original negotiations.[41] That left dissatisfaction with the bargain as the only basis for contract

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[35] *Id.* (*citing* Exh. DYN-38 at 1).

[36] *Id.* (*citing* Exh. MAEM-25 at 6:20-9:22; Exh. COR-48; Exh. COR-50; Exh. CAL-163 at 1:22-2:7).

[37] *Id.* at P41 (*citing Papago*, 723 F.2d at 953 n.4).

[38] *Id.* at PP 42-60 (*citing* numerous record exhibits).

[39] *Id.* at P 8.

[40] *Id.* at P 61.

[41] *Id.* at P 62.

modification, an insufficient basis under the public interest standard.[42]

21. Requests for rehearing were filed by Public Utility District No. 1 of Snohomish County, Washington (Snohomish), Californians for Renewable Energy (CARE), jointly by Complainants, and jointly by Coral, Dynegy, Mirant and Sempra (Indicated Sellers). Sempra filed an est for rehearing, and Complainants filed an answer in response.

II. Discussion

A. *Procedural Matters*

1. *Ex Parte Allegations*

22. Complainants request that we vacate the June 26 Order and that Chairman Wood and Commissioner Brownell recuse themselves from further proceedings in this matter because, after a Commission open meeting and press conference, Chairman Wood and Commissioner Brownell briefed a group of Wall Street analysts, via a telephone conference, about the open meeting.[43] We deny

23. We incorporate and reiterate our finding in an order issued in Docket No. EL02-28 on April 23, 2003,[44] and in an order denying rehearing in that same docket issued

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[42] *Id.* at P 8, 62 (*citing Potomac Electric Power Company v. FERC*, 210 F.3d 403, 409 (D.C. Cir. 2000) (*PEPCO*); *Soyland Power Cooperative, Inc. v. Central Illinois Public Service Company*, 51 FERC ¶ 61,004. at p. 61,013, *reh'g dismissed as moot*, 52 FERC ¶ 61,149 (1990); *Papago*, 723 F.2d at 953; *Sierra*, 350 U.S. at 354-355).

[43] Complainants' Reh'g Request at 2, 73-75 (*citing* Special Inquiry findings issued by the U.S. Department of Energy Office of the Inspector General on June 27, 2003 (Special Inquiry findings)).

[44] *Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al.*, 103 FERC ¶ 61,080 (2003).

contemporaneously with this Order,[45] that the telephone conference briefing, in which the Chairman and Commissioner Brownell simply repeated what they already had discussed at the open meeting and provided general background information, was not an inappropriate *ex parte* communication and did not taint this proceeding.[46]

Inquiry findings do not change this conclusion. In fact, fy evidence, based on that available record, substantiating the allegation that the conduct of the call violated any Commission procedural

representatives from 12 companies interviewed, nine of whom acknowledged participating in some or all of the conference call] stated that Chairman Wood or Commissioner Brownell explicitly indicated, during the conference call, how they would vote on the contract cases."[47]

24. Neither the Chairman nor Commissioner Brownell has prejudged the issues here, and, contrary to Complainants' assertion,[48] *ex parte* com-

the Chairman and Commissioner Brownell are therefore neither necessary nor appropriate in this case. We also reiterate our finding in the June 26 Order, at Appendix B, that Complainants' motion for disclosure of the telephone conference briefing is moot, as a summary of events relating to that briefing was filed in the record on April 22, 2003.

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[45] *Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al.*, Docket No. EL02-28-004, *et al.*

[46] *Nevada Power Company, et al., v. Enron Power Marketing, Inc., et al.*, 103 FERC ¶ 61,080 (2003).

[47] Special Inquiry findings DOE/IG-0610 June 2003, Results of the Inquiry p. 3.

[48] Complainants' Reh'g Request at 2.

25. Even assuming the conference call was a prohibited off-the-record communication, the violation has already been remedied, as disclosure, not recusal, is the appropriate remedy. Administrative proceedings blemished by *ex parte* communications may be remedied administratively by disclosing the communication and its contents.[49] In this regard, in the context of a Commission case, the court found that, by placing summaries of meetings Commission officials held with industry officials, other parties were apprised "of any argument that may have been presented privately, thereby maintaining the integrity of the process and curing any possible prejudice that the contacts may have caused."[50]

26. In addition, in *Louisiana*, the court made clear that recusal was not necessary or desirable even though there may have been *ex parte* communications.[51] Recusal here, therefore, would be an extraordinary and unwarranted remedy.[52] In *Power Authority of the State of New York*, the court explained that:

> recusal would be required only if the communications posed a serious likelihood
> ability to act fairly and impartially in the matter before it. In resolving that issue, one must look to the nature of the communications and particularly to

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[49] *See* 5 U.S.C. § 557(d)(1)(C)&(D); *Professional Air Traffic Controllers Organization v. Federal Labor Relations Authority*, 685 F.2d 547, 565 n.36 (1982).

[50] *Louisiana Ass'n of Indep. Producers v. FERC*, 958 F.2d 1101, 1112 (D.C. Cir. 1992).

[51] *Id.* (*citing FTC v. Cement Inst.*, 333 U.S. 683, 702 (1948) ("It is expected that administrative official will build up expertise through experience with recurring issues.") and *Laird v. Tatum*, 409 U.S. 824, 837 (1972) ("Such expertise should not lightly be tossed aside.")).

[52] *See Power Authority of the State of New York v. FERC*, 743 F.2d 93, 110 (2d Cir. 1984) ("The mere existence of such communications hardly requires a court or administrative body to disqualify itself.").

whether they contain factual matter or other information outside of the record, which the parties did not have an opportunity to rebut.[53]

27. As described above, the conference call contained no factual matter or other information outside the record, and, even assuming it did, Complainants had ample chance to rebut it at the oral argument or by filing a response.

2. *Mirant Bankruptcy*

28. On September 12, 2003, the Bankruptcy Court for

straining Order Against the Federal Energy Regulatory *In re Mirant Corp. (Mirant Corp. v. FERC)*, Adversary Proceeding No. 03-4355, which enjoins y action, directly or indirectly, to require or coerce the [Mirant] Debtors to abide by the terms of any Wholesale Contract [to which a Mirant Debtor is a party] which Debtors are substantially performing or which Debtors are not performing pursuant to an order of the court unless FERC shall have provided the

detail the action which FERC seeks to take with respect to any Wholesale Contract which is the subject of this

29. Should the TRO be converted into a preliminary injunction, an action that the Commission opposes, the Com-

disagreement with the validity of the TRO and its expectation that the TRO (or a preliminary injunction) will be vacated on appeal, the Commission must comply with it until vacated. The TRO requires ten days' written notice before the Commission takes a proscribed action with respect to a covered Mirant Wholesale Contract. Accordingly, to the extent that this Order requires Mirant to act in a manner proscribed by the TRO, the Order will provide written notice to Mirant of the action that FERC will take with respect to a covered Mirant Wholesale Contract, which action will not become effective until ten (10) days after issuance of this Order. In all other respects, this Order is effective immediately.

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[53] *Id.*

3. *Other Procedural Matters*

30. On July 26, 2003, as amended on September 2, 2003 and September 5, 2003, CARE filed a request for rehearing in this proceeding. As CARE acknowledged, it is not a party in this proceeding,[54] and it has not sought to intervene. As requests for rehearing can only be filed by parties,[55]

and Procedures, 18 C.F.R § 385.713(d) (2003), prohibits answers to requests for rehearing. Accordingly, we will reject
file a limited answer to Com-
plainants' request for rehearing. Under Rule 213(a) of the
and Procedure, 18 C.F.R.
§ 385.213 (2003), no answer may be made to a protest or answer unless otherwise ordered by the decisional authority. Good cause does not exist to justify accepting Complain-
on to file a limited answer;
therefore, we will reject this answer.

B. *Substantive Issues*

1. *Whether The Public Interest Standard Applies.*

32. Complainants and Snohomish argue that, in the June 26 Order, the Commission violated its statutory obligation to ensure just and reasonable rates when it determined that it could impose a higher burden of proof before mitigating unjust and unreasonable prices in the contracts at issue. They state that the Commission can apply the

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[54] CARE Reh'g Request at n.6.

[55] *See* 18 C.F.R. § 385.713(b) (2003).

public interest standard to determine whether prices should be mitigated only after its finds that the contract prices at issue here are just and reasonable.

33. As discussed below, the Commission has not violated its statutory obligation with respect to modification of contracts, as interpreted by the U.S. Supreme Court. The *Mobile-Sierra*
have negotiated a . . . contract that sets firm prices . . . and that denies either party the right to change such prices [ ] unilaterally, [the Commission] may abrogate or modify the contract only if the public interest so requires."[56] Under the public interest standard, the sole concern of the Commission is whether the challenged rate adversely affects the public interest,[57] and the Commission can exercise its authority to modify contracts only where the public interest demands such action.[58] The burden to demonstrate that the contract rates in question in this proceeding are contrary to the public interest is on the Complainants. The Complainants in this proceeding, however, have failed to make such a showing. As established in the June 26 Order and affirmed in this order on rehearing, the contracts at issue are subject to the public interest standard of review. Once a party signs a *Mobile-Sierra* contract, it cannot escape by later claiming that the rates were not just and reasonable when it signed the contract, unless there is evidence such as the seller fraudulently inducing the buyer to execute the contract. However, no such evidence was found in the evidentiary record, including the Staff Report and the 100-Day Discovery Proceeding submittals.

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[56] *Texaco*, 148 F.3d at 1095.

[57] *Sierra*, 350 U.S. at 354-5.

[58] *Union Pacific Fuels, Inc.*, 129 F.3d 157, 161 (D.C. Cir. 1997) (quoting *Metropolitan Edison Co. v. FERC*, 595 F.2d 851, 856 n.29 (D.C. Cir. 1979)).

34. In response to the Co

the Commission can apply the public interest standard of review only after it finds that the contract rates were just and reasonable,[59] Complainants fail to acknowledge that the contracts were lawfully entered into pursuant to prior findings and authorization by the Commission under Section 205 of the FPA.[60] Upon a showing that the seller lacks or has mitigated market power in the relevant market, the Commission pre-determines under Section 205 of the FPA that sales at market-based rates will be just and reasonable.[61]

and reasonable determination which applies to subsequent market-based sales made by the seller. As we explained in our June 26 Order, if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate authority, it would make the original grant of authority a pointless exercise of no value to anyone.

35. The Commission has held that this grant of market-based rate authority constitutes what is known as the

Then, if the parties have not agreed to apply the public interest standard to future challenges, a party may come to the Commission pursuant to Section 206 of the FPA[62] and demonstrate that the rate is no longer just and reasonable. Alternatively, a party who does not have such a right may seek changes by demonstrating that the contract rate is contrary to the public interest. In essence, the Complainants and Snohomish attempt to add another layer to this two-step process, claiming that parties to contracts that are subject to the public interest standard of review should have another opportunity to argue that the rate was not just and reasonable at the outset. This argument, however, has no support in either the statute or the relevant Commission or court precedent. Indeed, the Complainants' suggested approach would create uncertainty in the market, as a party who suddenly finds that its deal has become uneconomical, can undo the terms to which it was contractually bound. This is precisely what the *Mobile-Sierra* doctrine was designed to avoid, and we see no support for an exception to this established doctrine simply because a party has contracted in a market-based rate regime.

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[59] *See also* Snohomish Reh'g Request at 11, 12, 14-15, 18-22, 35.

[60] 16 U.S.C. § 824d (2000).

[61] *Louisiana Power Authority v. FERC*, 141 F.3d 364, 365 (D.C. Cir. 1998); *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993).

[62] 16 U.S.C. § 824e (2000).

36. Our decision in *Lockyer*[63] supports this result. The formula rate models satisfy the statutory framework fundamentally misapprehends the [64] *Lockyer* held that market-based rate certificates satisfy the FPA Section 205(c)[65] requirement that rates be on file with the Commission and recognized that the Commission reviews the reasonableness of the use of market-based rates prior to their consists, however, not of the particular prices agreed to by willing buyers and sellers. Rather, it consists of analysis to assure that the seller lacks or has mitigated market power so that its prices will fall within a zone of reasonableness."[66]

37. Thus, at the time sellers are granted market-based rate certificates, their rates are subject to the initial review required by the FPA. This review is different than that

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[63] *State of California ex re Lockyer v. British Columbia Power Exchange Corp., et al.*, 99 FERC ¶ 61,247 (2002) (*Lockyer*).

[64] *Id.* at p. 62,062.

[65] 16 U.S.C. § 824d(c) (2000).

[66] *Lockyer*, 99 FERC at p. 62,063.

genuine alternatives provides a sufficient basis . . . to con-

prices that sellers charge within the statutorily-prescribed
[67]

ment that this approach is insufficient to satisfy the statute. Our decision in *Lockyer* is on all fours with our finding here.

38. Indicated Sellers seek clarification that the public interest standard of review does not authorize unjust and unreasonable rates. We clarify as follows. Indicated Sellers are correct that rates initially must be just and reasonable. For market-based rates, this determination is made when the authorization for market-based rates is granted. However, if rates subsequently become unjust and unreasonable and the contract at issue is subject to the *Mobile-Sierra* standard of review, the Commission under court precedent may not change the contract simply because it is no longer just and reasonable. If parties' market-based rate contracts provide for the public interest standard of review, the Commission is bound to a higher burden to support modification of such contracts. The public interest standard applies to changes to contract rates and

ance between private contractual rights and the regulatory power to modify contracts when necessary to protect the
[68] Our finding that changes to the challenged contracts should be evaluated under the public interest standard does not equate to a finding that the underlying rates are not just and reasonable. To the extent

mission to opine on matters not before us in this case, we decline to do so.

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[67] *Id.*

[68] *Northeast Util. Serv. Co., v FERC*, 55 F.3d 686, 689 (1st Cir. 1995).

39. Complainants assert that the dysfunction in the spot market caused the rates in the specific long-term market-based rate contracts at issue here to be unjust and unreasonable from the outset and, therefore, that the just and reasonable standard of review, rather than the *Mobile-Sierra* public interest standard of review, should apply.

Commission to uphold the presumption that the prices in any contract entered during the California energy crisis for delivery in the Western markets by a seller with market-based rate authority are just and

[69]

40. Because a party who has executed a *Mobile-Sierra* contract cannot avoid its burden to show that a unilaterally proposed change is required by the public interest by claiming that the rates were not just and reasonable when that party executed the contract (unless, *e.g.*, the contract was induced by fraud committed by the seller on the buyer),

41. We also find no merit

garding the testimony of Drs. Tabors and Stoft, which, as is clear from the testimony itself as well as from Com-

rehearing request, and other pleadings, were based on forward price curves (forward price curves internally generated by each seller, and the one produced by Navigant Consulting for the buyer). All of these forward price curve models project the various input costs (*e.g.*, the cost of gas, NOx emission allowances) under expected future supply and demand conditions. The resulting forward price curves project the forward spot market prices for delivery of electricity over a period in the future. The sellers argue that they used their forward price curves as a floor and negotiated for higher prices. Meanwhile, Complainants argue

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[69] Complainants' Reh'g Request at 68.

generated price curves) stood as a ceiling and CDWR negotiated for a lower price.

42. Complainants use the expert testimony to argue that: the forward price curves can appropriately be used to test the justness and reasonableness of the rates under the long term contracts; because the forward curve model used by CDWR incorporated inputs that were not cleansed of market dysfunction, the rates CDWR negotiated were excessive; in late May 2001, the forward and spot prices declined synchronously purportedly proving that high spot prices caused forward prices to be excessive. The sellers disputed all these arguments.

43. Forward price curves are internally generated, proprietary information used by a party for its own purposes. Each seller and buyer uses its own projections and updates these daily or more often if circumstances change rapidly. Each model is slightly different in its assumptions and therefore will produce different price estimates. While this data is useful for resource planning and contract negotiation purposes, we cannot use that data to judge contract rates. Not only were these forward curve models not designed for that purpose, but the requisite transparency that Commission rate review must have is absent. Moreover, the Commission has never addressed or approved any one particular forward curve model for this purpose, and we find that, even if we could do so, we cannot do so on the record here. Accordingly, we find that it would be inappropriate to rely on the forward price curves and the testimony regarding those curves.

sue should be modified because they differ from the advisory benchmark we provided in the December 15, 2000

Order fails as well. Additionally, Snohomish asserts that the Commission arbitrarily and capriciously found that CDWR achieved its central objective in establishing its energy portfolio despite the fact that the average price for the first five years of the terms of the contracts exceeded the advisory benchmark.[70]

45. Complainants refer to our December 15, 2000 Order[71] in which we declined to extend the California spot market mitigation measures to forward markets.[72] In that order, we also adopted an advisory benchmark of $74/MWh for five-year contracts for supply around-the-clock to be used as a reference point in addressing any complaints regarding the pricing of contracts negotiated in forward markets. While we expected that the benchmark would be helpful in assessing possible complaints challenging forward prices, we never suggested that a contractual price exceeding the benchmark would be all by itself a sufficient ground for abrogating a contract. Quite to the contrary, we

benchmark] to the extent they believe the particular contract or supplier brings value which suits their needs (*e.g.*, shorter term contracts, favorable terms and conditions, assignment of the risk of variable cost exposure, the particular characteristics of the supplier or its resource portfolio, *etc* [73]

46. Complainants conceded below that the Dynegy, Mirant and Sempra contracts do not lend themselves to comparison with the five-year advisory benchmark.[74] Thus,

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[70] Snohomish Reh'g Request at 36.

[71] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv.*, 93 FERC ¶ 61,294 (2000) (December 15 Order).

[72] *Id.* at p. 61,994.

[73] *Id.* at p. 61,995.

[74] Complainants' January 10, 2003 Post-Hearing Brief at 92, 98, App B p. 27.

the benchmark arguments apply only to the Coral contract. To apply the $74/MWh benchmark we set in the December 15 Order for a five-year, supply around-the-clock benchmark to the 11-year Coral contract that does not provide for supply around-the-clock, Comp
hybrid analysis.[75] That analysis used the benchmark rate

segmented forward curve for the remainder of the contract. We never intended such a hybrid approach to be used for benchmark comparisons, and we find that approach unsupported and unacceptable. We already have explained that it would be inappropriate

47. Snohomish argues that
r for purposes of granting market-based rate authority cannot assure that all the rates the seller subsequently charges will be just and reasonable under all circumstances.[76]
tion. Indeed, we have recogn
complaint procedures apply when it appears that [market-
[77] Should a seller acquire market power subsequent to the Commis-
based rates, there is a safeguard that "places sellers on notice that their transactions will be subject to review and to prospective remedial action, including the possible loss of their market-pricing authori-
[78]

remedial authority does not require contract modification where the contract limits changes to those required by the public interest under *Mobile-Sierra.* As discussed, there has been no showing to support a finding that respondents exercised market power while selling under their market-based pricing authorization with regard to these specific contracts. Thus, there is no reason to move beyond the self-imposed limits on contract changes set by the parties in the challenged contracts. This result is consistent with both our responsibility to assure that market-based rates are just and reasonable and our long-standing respect for the sanctity of private contracts.

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[75] Exh. CAL-112.

[76] Snohomish Reh'g Request at 17, 26-29 (*citing AEP Power Marketing, Inc.*, 97 FERC ¶ 61,219 (2001); *Enron Power Marketing, Inc.*, 103 FERC ¶ 61,343 (2003); *Enron Power Marketing, Inc.*, 104 FERC ¶ 63,010 at P 128 (2003)).

[77] *Lockyer* at p. 62,064.

[78] *Id.* at p. 62,065.

tion, based on *Borough of Lansdale v. FPC*[79] *and Richmond Power & Light v. FPC,*[80] that *Mobile-Sierra* applies to contracts not on file with the Commission. Contrary to *Lansdale* and *Richmond*

based rate certificates [are entitled] to charge unjust and unreasonable rates."[81] Instead, as Snohomish itself concedes, the Commission relied on the *Lansdale* and *Richmond* cases to demonstrate that a party may not circumvent *Mobile-Sierra*

with the Commission.[82] The Commission reasoning here was sound.

49. Snohomish further argues that the Commission should have reviewed the contracts at issue under the just and reasonable standard to protect the rights of third

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[79] 494 F.2d 1004, 1113 (D.C. Cir. 1974).

[80] 481 F.2d 490, 497 (D.C. Cir. 1973).

[81] Snohomish Reh'g Request at 16-17.

[82] *Id.* at 16 (claiming that the cases hold that "utilities do not gain the right, denied them by the *Mobile-Sierra* doctrine, to challenge contract rates as too low simply by failing to comply with the FPA's requirement that all jurisdictional contracts be on file with the Commission.").

parties, especially electric ratepayers.[83] In addition, Snohomish contends that the Commission at the very least should have applied the flexible public interest standard.[84]

50. There is no Commission or court precedent that supports a finding that a non-signatory party may challenge a *Mobile-Sierra* contract under the just and reasonable standard of review, as opposed to the public interest standard of review. The cases cited by Snohomish as dictating application of the just and reasonable standard of review are inapposite. In *PJM Interconnection, LLC*,[85] the Reliability Assurance Agreement explicitly permitted PJM to submit filings under Section 206 of the FPA.[86] In the instant proceeding, the contracts in question do not contain such a provision. Snohomish also cites to *Carolina Power and Light Co.*[87] which involved a Commission directive to revise a settlement agreement that had been submitted for Commission acceptance, and not, as in this case, a complaint challenging an existing market-based rate contract for the sale of power. Finally, Snohomish refers to *Pennsylvania Electric Co.*[88] which speaks in general terms about the Commission's statutory duty to ensure just and reasonable rates. However, the Commission has applied the public interest standard of review to challenges brought by noncontractual parties.[89] In addition, we found no basis for applying a more flexible public interest standard to the contracts at issue. The record shows that the third-party intervenors were not adversely affected by the contract at issue.

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[83] Snohomish Reh'g Request at 39-40.

[84] Snohomish Reh'g Request at 41 (*citing* Snohomish Brief on Exceptions at 13-15).

[85] *PJM Interconnection, LLC*, 96 FERC ¶ 61,206 (2001).

[86] *See id.* at p. 61,878 n.12.

[87] *Carolina Power and Light Co.*, 69 FERC ¶ 61,078 (1994).

[88] *Pennsylvania Electric Co. v. FERC*, 11 F.3d 207 (D.C. Cir. 1993).

[89] *See, e.g.*, July 23 Order, 100 FERC at p. 61,396.

Similarly, Complainants have failed to show that the contracts at issue imposed an exce

ratepayers.

51. Complainants and Snohomish nonetheless assert that the *Mobile-Sierra* public interest standard of review does not apply to the contracts at issue because, purportedly, Complainants are third parties to the contracts as CDWR, rather than the CPUC or CEOB, executed the contracts. As we previously found,[90] however, the State of California, through one of its agents, CDWR, was a party to the contracts. Complainants, like CDWR, are agents of the State of California, and, therefore, in bringing these complaints, Complainants stepped into the shoes of CDWR as a representative of the State of California. Complainants' own rehearing request supports this conclusion. Throughout the rehearing request, Complainants acknowledge that the buyer under these contracts was the State of California.[91]

52. There also is no merit

that "[t]o address concerns about potentially unjust and unreasonable rates in the long-term markets, we will

[92]

sellers that the Commission would scrutinize long-term

[93] The

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[90] June 26 Order at P 76.

[91] *See, e.g.*, Complainants' Reh'g Request at 48 ("the State of California was forced to step in as the entity responsible for purchasing California's "net short,"); Complainants' Reh'g Request at 32 ("it was necessary for the State of California to take the unprecedented step of becoming the buyer for most of the load of the entire state. It did so by authorizing CDWR to purchase the State's 'net short . . . ."); Complainants Reh'g Request at 63 ("the State on the public's behalf . . . enter[ed] the long-term contracts").

[92] December 15 Order, 93 FERC at p. 61,994.

[93] Complainants' Reh'g Request at 9.

referenced statement in the December 15 Order did not, and did not intend to, inform any one that unilaterally proposed rate changes to contracts universally would be reviewed under a just and reasonable standard of review. Under *Mobile-Sierra*, unless the parties to a contract reserve their rights to unilaterally propose a rate change, the Commission can grant a unilateral request for a rate change only if the proposed change is required by the public interest. We cannot, and did not attempt to, trump the mandates of that long-standing case law.

53. There also is no merit to Complainants

that the *Mobile-Sierra* doctrine does not apply to the contracts here because the doctrine is not intended to protect the sanctity of contracts entered into by wrongdoers[94] or the contention that the public interest standard of review is

the public interest for sellers

to retain the benefits of contracts entered into by virtue of their market-based authority, but which market-based au-

[95] Complainants do not cite to any precedent for these propositions. More importantly, the wrongdoing cited by Complainants involves alleged activities by Mirant and Dynegy in the spot markets, not the forward markets. As mentioned above, we found nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation *specific to* the long-term contract negotiations resulting in the prices and terms challenged here.[96]

itial decision in the June

Mobile-

Sierra doctrine arose in the context of a completely regulated environment, where, as here, the contracts were entered into under the partie

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[94] Complainants' Reh'g Request at 10-12, 22.

[95] Complainants' Reh'g Request at 12.

[96] June 26 Order at P 61.

ty, the Commission has stated that '[p]reservation of the contracts has, if anything, be [97]

Complainants ask us to explain this statement. As we explained in the April 25 Order:

> nding policy, consistent with a substantial body of Supreme Court and other judicial precedent, has been to recognize the sanctity of contracts. Rarely has the Commission deviated from that policy, and then only in extreme circumstances, such as the fundamental industry-wide restructuring under Order No. 888 and the reorganization of a bankrupt utility. Preservation of contracts has, if anything, become even more critical since the policy was first adopted. Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are *extraordinary circumstances*.[98]

55. The critical point is not, however, that sanctity of contracts is even more important in a market-based rate system, but that sanctity of contracts remains vitally important whether the regulatory system is cost-based or market-based.

56. Snohomish argues that the *Mobile-Sierra* doctrine applies only in situations where a regulated utility is challenging a contract with a rate it argues is too low.[99] As we

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[97] *Id.* at P 64 (*quoting Partial Initial Decision,* 102 FERC ¶ 63,013 at P 31 (*quoting* April 25 Order, 99 FERC at p. 61,383)).

[98] April 25 Order, 99 FERC at p. 61,383 (footnote omitted).

[99] Snohomish Reh'g Request at 12.

Sierra doctrine was applied to contracts containing rates [100] Snohomish, however, believes that the *PSC of New York*[101] case the Commission relied on is inapposite.[102] We disagree. The court in *PSC of New York* held that the *Mobile-Sierra* doctrine protects contracts, not rates; it obligates both buyers and sellers, and the Commission is no more at liberty to alter a contract

[103] In addition, the *Mobile-Sierra* doctrine has been applied in other cases where a complainant sought to reduce the existing rate.[104]

2. *Whether Complainants Met Their Public Interest Burden.*

57. Complainants also argue that they have met their public interest burden regarding the contracts at issue. First, Complainants, and Snohomish, assert that the Commission failed to recognize that the three-part *Sierra* "test" is not the sole measure of the public interest standard.[105] This assertion is incorrect. The June 26 Order explicitly found that the Complainants failed to demonstrate any of the three public interest factors addressed in *Sierra or any other factors* showing that modifying the contracts is required by the public interest.[106] On rehearing, we also have fully considered and a
public interest claims. Our discussion of those claims in the June 26 Order and in this Order makes clear that we reject

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[100] June 26 Order at P 6.

[101] *Public Service Commission of the State of New York v. FPC,* 543 F.2d 757 (D.C. Cir. 1974) (*PSC of New York*).

[102] Snohomish Reh'g Request at 15-16.

[103] *PSC of New York*, 543 F.2d at 798.

[104] *PEPCO*, 210 F.3d 403.

[105] Complainants' Reh'g Request at 13, 15, 64, 65; Snohomish Reh'g Request at 32.

[106] June 26 Order at PP 8, 39.

the claims not because we believe we are restricted to considering only the three factors enunciated in *Sierra*, but because we find the claims do not satisfy
public interest burden. Thus, we reject this and any other arguments premised on the Commission restricting its consideration of the public interest to the three factors addressed in *Sierra* because they have no basis in fact. For these same reasons, we reject
the Commission ignored every aspect of the public interest outside of the contract negotiations despite evidence of fraud, abuse and manipulative practices.[107]

58. Snohomish argues that the June 26 Order is inconsistent with decisions in *French Broad Elec. Membership Corp. v. Carolina Power & Light Co.*[108] and *Texaco v. FERC*.[109] In addition, Snohomish claims that the public interest is met because (1) there is evidence that the bargaining process leading to the execution of the contracts was not the product of a functionally competitive market, and (2) after a period of market dysfunction, the contracts were no longer economical.[110]

59. In the June 26 Order, we determined that Complainants failed to demonstrate that contract modification was required by the public interest.[111] We considered whether Complainants had demo
three prongs announced in the *Sierra* case [was] met or that any other factor introduced into evidence warrant[ed] a finding that any of the contracts is contrary to the public
[112] We found none of the

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[107] Snohomish Reh'g Request at 34-35.

[108] 92 FERC ¶ 61,283 (2000).

[109] *Texaco*, 148 F.3d at 1097.

[110] Snohomish Reh'g Request at 33-34.

[111] June 26 Order at PP 3, 8, 39, 60-63.

[112] *Id.* at P 39.

Sierra

impair the ability of the public utility to continue service, cast upon other consumers an excessive burden, or be unduly discriminatory. Moreover, we considered the totality of the circumstances preceding and following the execution of the contracts and found that none justified contract modification.

Atlantic

City Elec. Co. v. FERC,[113] *Northeast Utils. Service Co. v. FERC,*[114] and *Town of Norwood v. FERC*[115] to be misplaced.

three demonstrate that the public interest standard of review is met when "there is evidence that the bargaining process leading to the execution of the contracts was not the product of a

[116]

reading of the cases is not entirely accurate. All three cases recognize that *Mobile-Sierra*

as reflected in the contract, when there is no need to question what transpired at the contract formation stage.[117] Our decision here is consistent with those cases, as there has been no showing to support a finding of fraud, duress, or the exercise of market power at the contract formation stage.[118]

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[113] 295 F.3d 1, 14 (D.C. Cir. 2002), *remanded*, 101 FERC ¶ 61,318 (2002), *vacated in part*, 329 F.3d 856 (2003).

[114] 993 F.2d 937, 961 (1st Cir. 1993), *remanded*, 66 FERC ¶ 61,332, *reh'g denied*, 68 FERC ¶ 61,041, *aff'd*, 55 F.3d 686 (1995).

[115] 587 F.2d 1306, 1313-14 (D.C. Cir. 1978).

[116] Snohomish Reh'g Request at 33.

[117] 295 F. 3d at 14; 993 F.2d at 961; 587 F.2d at 1313-14.

[118] Contrary to Snohomish's argument, we did not, nor did we intend to "require[] a showing of unfairness, bad faith, or duress" to modify contracts under the public interest standard. Snohomish Reh'g Request at 37. In our June 26 Order, we recognized these criterion as three possible grounds to support a public interest finding, but in no way limited our inquiry to these three.

there are broad policy concerns sufficient to satisfy *Mobile-Sierra* [119] There is no policy initiative that would be served by modifying the challenged contracts. The cases on which Snohomish relies involve as the fundamental industry-wide restructuring under Order No. 888 and the reorganization of a bankrupt utility."[120] Contract modification here is, if anything, contrary to specting contract sanctity and creating the regulatory certainty needed to attract sufficient capital to competitive power markets.

62. Indicated Sellers contend that we erred to the extent we relied in the June 26 Order on extrinsic evidence in determining that the public interest standard of review applies to the contracts at issue. Indicated Sellers seek clarification or rehearing that, unless contractual language preserves rights to make unilateral application to the Commission for changes in rates, the *Mobile-Sierra* public interest standard of review applies. We deny clarification or rehearing on that issue here. Complainants made clear submitted evidence, to the effect that the absence of an explicit *Mobile-Sierra* provi-

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[119] Snohomish Reh'g Request at 33 & n. 117; 37-38 & n. 137.

[120] April 25 Order, 99 FERC at p. 61,383 (*citing Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Service by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, *FERC Statutes and Regulations, Regulations Preambles January 1991-June1996* ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, *FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000* ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group, et al. v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002); *Northeast Util. Serv. Co.*, 66 FERC ¶ 61,332, *reh'g denied*, 68 FERC ¶ 61,041 (1994)).

sion in the [Dynegy and Sempra] contracts is itself a basis for not applying the *Mobile-Sierra* standard to those
[121] Thus, Complainants
extent the *Mobile-Sierra* standard applies to the contracts with explicit *Mobile-Sierra* provisions [the Mirant and Coral contracts], it applies to the contracts without such
[122]

63. Next, Complainants clai
public interest for the ultimate consumers to be burdened with contracts that impose unjust and unreasonable rates."[123]
are imposed directly on the public, unjust and unreasonable does mean contrary to the public interest."[124]

64. While Complainants have alleged that the contract

that allegation, even if true, does not establish that the contract rates are contrary to the public interest. Our
e fact that a contract has become uneconomic to one of the parties does not necessarily render the contract cont
[125]

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[121] *See* Partial Initial Decision at P 44 (*quoting* Complainants' January 14, 2003 Answer to Motion to Hold Briefing in Abeyance).

[122] *Id.*

[123] Complainants' Reh'g Request at 12.

[124] Complainants' Reh'g Request at 72; *see also* Complainants' Reh'g Request at 17-18.

[125] *PEPCO*, 210 F.3d at 409. Snohomish contends that the Commission erred in relying in its decision on PEPCO in which the court held that a showing of "a mere rate disparity or a benefit to the purchasing utility or its customers for a rate modification does not suffice, without more, to satisfy [the 'public interest'] standard." *Id.* at 404. In Snohomish's opinion, *PEPCO* and the instant case are factually different and thus *PEPCO* is inapplicable. In deciding whether the Complainants met their burden of proof under the public interest standard of review, we were guided by the court case law developed over several decades. Upon the review of the evidentiary record developed in this proceeding, the findings of the Staff Report, and evidence submitted in the 100-Day

Additionally, even if the contract rates at issue will be passed through entirely to ultimate customers, Complainants have failed to show that would be contrary to the public interest.

65. We agree with Complainants that an important public interest is the interest in functioning competitive markets. In this proceeding, however, we have found that the record does not substantiate that the contracts in question caused financial distress for the Complainants (or others they represent), threatening their ability to continue service; that the contracts cast an excessive burden on customers; that the contracts were unduly discriminatory; or any other factors showing that modifying the contracts is required by the public interest,[126] and we have found nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation *specific to* the long-term contract negotiations resulting in the prices and terms challenged here.[127] Therefore, we find no merit to Com-

r determination that modifica-
tion of the instant contracts is not required by the public interest allows "market abusers [to] keep the benefits of high

[128]

tively declares that as between remedying unjust and un-

Discovery Proceeding, we concluded that the challenged contracts were not contrary to the public interest because the Complainants failed to demonstrate that the contracts in question caused financial distress for the Complainants (or others they represent) so as to threaten their ability to continue service, that the contracts cast an excessive burden on customers, that the contracts were unduly discriminatory to the detriment of other customers that were not parties to this proceeding, or that any other factors on the record of this proceeding demonstrate that the contracts were contrary to the public interest. June 26 Order at P 8.

[126] June 26 Order at PP 8, 39, 60.

[127] June 26 Order at P 61.

[128] Complainants' Reh'g Request at 16.

reasonable rates borne by the public itself resulting from circumstances involving seller misconduct . . . and allowing the same sellers to preserve the benefit of their unfair bargain, the latter is more [129]

66. We also find no merit on the facts here to Complainants' argument that "the Commission should find it is in the public interest to modify contra

[130] We have appropriately applied the public interest standard in this proceeding and found that Complainants have not met their burden of proving that the contracts cast an excessive burden on customers.

that the contracts should be modified even if the rates burden customers in some degree less than excessive[131] is similarly inapposite. We have appropriately applied the public interest standard of review in this proceeding and found that Complainants have not met their burden under that standard.

68. We also reject Complainants' argument that our determination that reformation of the instant contracts is not required by the public interest conflicts with our application of the public interest standard of review in *El Paso Natural Gas Co.*[132] In *El Paso*, consistent with our

circumstances, and only where the public interest so requires, will the Commission order contract modification. For example, the Commission has ordered contract modification in connection with its restructuring of the natural gas [133] Unlike in *El Paso*, where we found reformation necessary in the public interest because continued service under the existing contracts would continue the ever increasing degradation to firm service under those contracts contrary to the concept of firm service and our regulations,[134] we have determined that Complainants have not shown that any public interest requires contract modification here.

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[129] Complainants' Reh'g Request at 22; *see also* Snohomish Reh'g Request at 35 (arguing that the Commission has elevated the interests of regulated utilities above the interests of electric consumers).

[130] Complainants' Reh'g Request at 14.

[131] Complainants' Reh'g Request at 14; *see also* Snohomish Reh'g Request at 36.

[132] 99 FERC ¶ 61,244 (2002) (*El Paso*); Complainants' Reh'g Request at 16.

69. Complainants make a number of arguments challenging our finding that CDWR had options and at least some bargaining power when it entered into the portfolio of contracts at issue here. First, Complainants argue that the available alternatives "were not those that would have been presented in the absence of [135] t pertinent here. Complainants were required to meet the public interest standard of review, not the just and reasonable standard of review which could have taken into account the causal connection between the spot market prices and forward bilateral market prices.[136]

70. Moreover, Complainants' claim that "there is no evi- have met the California net short at just and reasonable [137]. improperly inverts the burden of proof here. Complainants, as the proponents of unilateral changes to *Mobile-Sierra* contracts, have the burden to show that the public interest requires contract modification. Thus, no one

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[133] *El Paso*, 99 FERC at p. 62,005 (footnotes listing citations omitted).

[134] *El Paso*, 99 FERC at pp. 62,003, 62,005-06.

[135] Complainants' Reh'g Request at 21.

[136] June 26 Order at P 37.

[137] Complainants' Reh'g Request at 20.

had the burden to establish that
have been met at just and reasonable prices.

71. Complainants' assertion that, because sellers had the choice of selling their power into the spot market rather than entering into long-term contracts with CDWR, CDWR lacked bargaining power and had to pay a significant premium to obtain the contracts at issue[138] fails as well. As the experience in California illustrates, sellers who choose to forego entering into long-term power sales contracts assume the risk that spot prices will decrease below the prices they could have obtained in those long-term contracts. Thus, both buyers and sellers have an equal incentive to avoid the price risks innate to spot market sales and to obtain the security long-term contracts provide.

72. Complainants also contend that the fact that CDWR received hundreds of long-term contract offers "does not establish that it had any meaningful bargaining power or
[139] Our determination that CDWR had bargaining power regarding the contracts at issue was based on our consideration of all the factors discussed in the June 26 Order, not merely on the large number of bids received.

73. Moreover, Complainants claim on the one hand that
[140] and, therefore, by definition in competition with each other, while

[141] In any event, that many of the bids received were mutually exclusive (or were for less than 100 MWs, or were made by unknown entities with no experience in the power indus-

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[138] Complainants' Reh'g Request at 49.

[139] Complainants' Reh'g Request at 49.

[140] Complainants' Reh'g Request at 49.

[141] Cmplanaints' Reh'g Request at 51.

try)[142] does not negate the myriad other factors we found [143] including that CDWR was able to assemble a portfolio of about 41 contracts for about 12,000 MW during the peak year.[144] And, while Complainants assert that [145] all of the contracts at issue here provided for deliveries during that summer.

cast CDWR as lacking bargaining power because, purportedly, the bids received reflected market dysfunction compared to cost-based pricing[146] fails as well. A disparity between market-based and cost-based rates is not sufficient to demonstrate a

75. Additionally, that CDWR purportedly made certain concessions regarding the terms of certain contracts[147] does not negate that CDWR was able to obtain many concessions from sellers, including obligating many, if not all, of the sellers to: (1) make immediate and/or near-term sales to CDWR at below-market prices, (2) assume transmission and congestion risk and provide high supply availability

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[142] Complainants' Reh'g Request at 51.

[143] *See, e.g.*, June 26 Order at P 43-59.

[144] June 26 Order at P 49.

[145] Complainants' Reh'g Request at 51.

[146] Complainants' Reh'g Request at 51.

[147] Complainants' Reh'g Request at 51-54, 59-60. Complainants assert that CDWR agreed to a longer term than it wanted in the Sempra contract in order to foster Sempra's construction of new power plants, but that "Sempra claims that the contract does not require it to build any of the plants whose output CDWR was contracting for, and Sempra has aggressively asserted its right, in its sole discretion, to refuse to build such plants and to provide power purchased in the market." Complainants' Reh'g Request at 59. That assertion does not reflect on CDWR's bargaining power but involves a contract interpretation dispute that does not belong in this proceeding.

generation, (4) assume the risk of changes in fuel prices, and (5) provide CDWR the option of choosing seller-supply and/or CDWR-supply of natural gas.[148] In certain contracts, even though the sellers proposed a fuel price indexing formula, CDWR insisted on a fixed price, thereby leaving sellers to bear the risk that fuel prices would increase in the future.[149]

76. Complainants protest that CDWR's ability to contract for energy in 2001 at below market prices does not indicate that CDWR had bargai
the contracts was priced above the then existing market forward price curve such that any below-market sales in 2001 were more than made up over the life of the
[150] That protest, like Co
ment, inappropriately compares internally generated forward price curves to contract rates in an attempt to show that the contract rates are unjust and unreasonable or contrary to the public interest. As we explained above, internally generated forward price curves cannot be used to judge contract rates. For the same reasons, they cannot be used to show lack of bargaining power. Even if Complainants' assumption were correct, however, that does not diminish that CDWR was able to bargain and contract for energy at below market prices in the immediate and/or near term, when energy was critically needed.

77. Complainants assert that CDWR did not want ten-year contracts but wanted contracts with terms of one to three years. That assertion is belied, however, by the fact

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[148] June 26 Order at P 54 (*citing* Exh. COR-1 at 46:3-47:5; Exh. AYE-14 at 3:1-4:20; Exh. EPME-28 at 10:4-14; Exh. MAEM-1 at 13:5-18; Exh. MSC-1 at 6:16-7:2; Exh. SER-1 at 25:8-26:21; Exh. DYN-1 at 26:15-27:3).

[149] *Id.* (*citing* Exh. S-1 at 25:8-11).

[150] Complainants' Reh'g Request at 59.

for bids did not indicate a
preference for any particular contract term.[151]

78. And, while Complainants assert that CDWR did not achieve its purported goal of one-to-three year contracts with an average price of $70/MWh, CDWR did achieve a central objective of obtaining a portfolio of contracts that yielded a weighted average price no higher than $70/MWh,

retail rates as of January 2001.[152] That CDWR may not have obtained the exact bargain it had in mind does not establish that it lacked bargaining power. Rather, it simply shows that the give-and-take innate to negotiation occurred.

79. Complainants also argue that the Commission erred in stating in the June 26 Or
fited from resales of the energy purchased under these
[153] because, in Com-

Commission cites none) that Complainants (or even CDWR) benefited from the power sales."[154]
plainants benefited from resales of the energy purchased under these contracts during the relevant period," we meant only that California benefited by entering into the contracts at issue because California was able to resell the power obtained under the cont
energy needs. The record certainly supports that finding.[155]

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[151] June 26 Order at P 48.

[152] June 26 Order at P 40.

[153] June 26 Order at P 8.

[154] Complainants' Reh'g Request at 21.

[155] Complainants' own rehearing request states that CDWR sought this outcome. Complainants' Reh'g Request at 49 (stating that CDWR chose to "purchase the electricity through long-term contracts and thereby reduce the reliance on the spot market and obtain a reliable supply at lower immediate cost.")

that the dysfunction in the spot markets, the California Power Exchange ceasing operations and declaring bankruptcy, the bankruptcy and near-bankruptcy of two

the unprecedented step of becoming the buyer for most of the load for the entire sta

circumstances that satisfy the *Mobile-Sierra* standard.[156] Complainants have not shown that, on balance, the prices in the challenged contracts harmed the public interest as envisioned in *Mobile-Sierra*.

81. Nor are Complainants correct that we did not consider the totality of the circumstances. In both the June 26 Order and here, we have considered the totality of the circumstances surrounding these contracts, including the California energy crisis and related events. Complainants have failed to establish, however, that any of those circumstances caused the contracts at issue to be contrary to the public interest.

82. Complainants' next contention, that the instant con-

excess of a just and reasonable price," which constitutes an extraordinary circumstance satisfying the *Mobile-Sierra* standard,[157] fails as well. Complainants do not cite the basis for their 33-60% figure, and we know of none in this record. Furthermore, we have found that the Complainants failed to demonstrate that the contracts in question cast an excessive burden on customers.[158]

83. While Complainants argue that they demonstrated that the contracts were priced above long-run competitive prices, they base that claim on the testimony and evidence

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[156] Complainants' Reh'g Request at 32.

[157] Complainants' Reh'g Request at 32.

[158] June 26 Order at P 8, 39, 60.

presented by Drs. Tabors and Stoft. We have found that testimony and evidence to be based on forward price curves that cannot appropriately be used for such a comparison.

did not, contrary to Complainants' assertion, "find[] that forward prices in the 1-2 year class of contracts [were] unjust and unreasonable as a result of spot market dys-

[159] The Staff Report did not make any findings regarding the justness and reasonableness of any contract rates and any such findings would not be relevant here because the just and reasonable standard is not applicable.

diminish the impact of the fact that CDWR assembled a highly sophisticated procurement team to assist in its contracting decisions is unavail-

phistication is part of the totality of the circumstances that informs our analysis of the public interest regarding the contracts in this case.

[160]

comments by the California officials indicating that they fully supported the price, terms and conditions made con-

along with all other factors, to our determination of whether the instant contracts should be modified under the FPA. For example, a memorandum prepared by a member of

stating that "[e]ach power purchase agreement was the subject of often protracted negotiations. Frequently, sellers had to concede numerous points to obtain the terms and provisions they ultimately

[161] confirms that numerous concessions were made by sellers to obtain the contracts. Similarly, CDWR's lead negotiator's statement that

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[159] Complainants' Reh'g Request at 42.

[160] Complainants' Reh'g Request at 56-57.

[161] June 26 Order at P 50 (*citing* Exh. AYE-51 at NAV08-016238; Tr. at 1561:14-1562:18).

gosh, this is higher than what the price might be. Well, hell, they don't know. We didn't just fall off a turnip truck. I am not saying we took the shirt off their back. But I am saying that these were fair, negotiated, hard-fought deals,"[162] contracting team was sophisticated and engaged in fair and real negotiations.

86. Complainants' claim that they demonstrated bad faith, unfairness and duress by the respondents, proffering aff Report and 100-day submissions that the entire California energy crisis was caused in large part by the rampant and widespread market manipulation by numerous sellers, which led to the insolvency of the IOUs and in turn forced the California public to enter the long term contracts through CDWR in order to [163] Complain- cause, even if true, it does not show bad faith, unfairness or duress by any seller in the original negotiations of the contracts at issue as is required. Furthermore, the record evidence demonstrates that market fundamentals such as increased demand, reduced generation and increased fuel costs were variables that contributed significantly to the escalation in market prices.[164]

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[162] *Id.* (*citing* Exh. DYN-26 at 152:16-153:8).

[163] Complainants' Reh'g Request at 63-64.

[164] Exh. MSC-7 at 5:15-6:3; MSC-7 at 8:12-9:12; Exh. AYE-1 at 13:1-9; Exh. MSC-7 at 11:20-12:4; Exh. MSC-7 at 9:15-10:6; Exh. MSC-7 at 10:7-12; Exh. MSC-7 at 11:6-9; Exh. COR-25 at 12:4-9; Exh. MSC-7 at 11:19-20; Exh. EPME-1 at 18:15-17; Exh. COR-25 at 11:6-13, 12:7; Exh. COR-25 at 18:12-22; Exh. EPME-1 at 28:13-15; Exh. COR-25 at 12:16; Exh. EPME-1 at 16:8-17:3; Exh. EPME-1 at 40:15-41:1; Exh. EPME-14A; Exh. EPME-1 at 21:6-11; Exh. MSC-7 at 59:3-16; Exh. COR-25 at 22:1-3; Exh. EPME-1 at 45:8-14; Tr. at 835:20-836:4; Exh. MSC-7 at 19:2-9; Exh. MSC-7 at 19:11-13; Exh. COR-25 at 15:16-17; Exh. EPME-1 at 18:5-14; Exh. EPME-3; Exh. COR-25 at 15:16-23; Exh. MSC-7 at 28:12-29:2; Exh. MSC-7 at 19:14-17; Exh. COR-25 at 23:19-24:6; Tr. at 839:8-9;

87. Snohomish argues that the June 26 Order suggests two contradictory tests for meeting the burden of proof under the public interest standard of review. According to Snohomish, these tests are the *Sierra* three-prong test and the requirement to show market manipulation specific to the contracts at issue, as well as "unfairness, bad faith, or
[165] In the alternative, Snohomish argues that the contracts were the product of market manipulation.

88. We disagree. In the June 26 Order, we did not create two different public interest tests. Our statement that "there [was] nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation *specific to* the long-term contract negotiations resulting in prices and
[166] was in response to the Complainants' contention that contract modification is warranted based on the Staff Report findings and the 100-Day Discovery Proceeding allegations of manipulation in the spot market. We reviewed the Staff Report findings and evidence submitted in the 100-Day Discovery Proceeding and found no evidence supporting a finding of market

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Exh. COR-25 at 14:2-4; Exh. AYE/SER-1 at 16:7-15; Exh. AYE-1 at 17:3-10; Exh. MSC-7 at 37:15-16; Exh. COR-25 at 11:6-13, 14:6-25; Exh. MSC-7 at 41:6-12; Exh. MSC-7 at 43:10-13; Exh. COR-25 at 23:12-18; Exh. MSC-7 at 39:5-10; Tr. at 838:20-25; Exh. EPME-1 at 22:5-11; Exh. MSC-7 at 31:8-13, 31:16-20; Exh. MSC-7 at 33:8-16; Exh. EPME-56 at 1:11-18; Exh. COR-48 at 12:15-17; Exh. EPME-1 at 21:9-22:2; *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv.*, 93 FERC ¶ 61,121 at p. 61,354-55, 61,358-59; Exh. S-2 at 7:6-17, 17:9-14. *See also* Oral Argument Transcript at 12:17-19 (May 15, 2003) ("We have recognized in our proceeding throughout, that there were underlying market fundamentals at work that created tight markets in California.").

[165] Snohomish Reh'g Request at 32-33, 37.

[166] June 26 Order at 61.

manipulation that specifically affected the contracts at issue.

89. Snohomish also challenges the Commission's finding ence of unfairness, bad faith, or duress in the original negotiations, Complainants are not entitled to change CDWR's bargains."[167] Snohomish contends that the showing of unfairness, bad faith, or duress is not required to meet the public interest standard of review.

90. We disagree. In the April 25 Order, we instructed the ALJ to consider and the parties to submit evidence on "the totality of purchases and sales and the conditions pre- [168] As we stated in the July 23 Order, the instructions were tailored to on the main issue that the [169] faith, or duress in the original negotiations" were not explicitly mentioned, such evidence could be relevant to the conditions present at the time of contract formation and whether the Commission should uphold or modify the challenged contracts. Moreover, as we stated in the July 23 Order, the list of evidentiary requirements was not exclusive; the parties were free to offer other evidence deemed by the ALJ to be relevant to the Commission-prescribed scope of the hearing.[170]

91. Furthermore, as Snohomish acknowledges in its rehearing request, the three-part *Sierra* and other factors can be considered.[171] We believe that a showing of fraud, duress, or bad faith between the parties at the contract formation stage could be an alternative

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[167] June 26 Order at 62; Snohomish Reh'g Request at 37.

[168] April 25 Order, 99 FERC at p. 61,384.

[169] July 23 Order, 100 FERC ¶ 61,098 at P 14.

[170] *Id.*

[171] Snohomish Reh'g Request at 32-34.

ground for modifying the challenged contracts. Our review of a broader range of evidence concerning the circumstances surrounding formation of the contracts at issue imposed no harm on the Complainants. However, the Complainants failed to make this showing; they also failed to meet the *Sierra* three-prong test or demonstrate that contract modification is justified based on the totality of circumstances.[172] On rehearing, we also have fully considered and addressed all of Co
claims. Our discussion of those claims in the June 26 Order and in this Order makes clear that we reject the claims because we find the claims do not satisfy
public interest burden.

92. Complainants also argue that the contracts should be modified because the requested remedy would allow every seller to recover all its legitimate costs, plus a reasonable rate of return, and that, in the extraordinary circumstances here, that remedy would not create precedent that would impede contract formation in the normal course. We cannot subvert the mandates of the *Mobile-Sierra* doctrine, however, absent demonstrated harm to the public interest. Complainants have not satisfied that burden here.

93. Complainants claim that the instant contracts must be modified to correct a lack of confidence in competitive markets caused by the energy crisis in California. Even assuming there is a lack of confidence in competitive markets caused by the energy crisis in California, Complainants are merely speculating, without making a supportive showing, that modifying the long-term contracts here would cure it. We find no basis for Complainants' speculative claim.

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[172] June 26 Order at PP 8, 39, 60-63.

94. Next, Complainants and Snohomish assert that it is inconsistent and a disincentive for buyers to enter into future long-term contracts for the Commission to order refunds of unjust and unreasonable spot market rates but to deny modification of the contracts here. In making this assertion, Complainants ignore that these spot market sales are not subject to the mandates of the *Mobile-Sierra* doctrine, while the long-term forward contracts at issue here are. Thus, while we are bound by a public interest standard in reviewing the complaint here, we are bound only by a just and reasonable standard in reviewing the California spot market sales. They also ignore that buyers can retain their rights to unilaterally file for rate changes under the just and reasonable standard by including a provision to that effect in their contracts. The latter fact also critically undermines Complainants *Mobile-Sierra* doctrine can be construed as providing a disincentive for long-term contracting.

95. While Complainants protest that we have held them to an inappropriate burden of proof, contending that they only had to come forward with a *prima facie* case, the law is clear that the proponent of a unilateral change to a *Mobile-Sierra* contract has the burden to show that the public interest requires that change.[173] We held Complainants to the appropriate burden of proof here. For this same

proof required in proceedings under Section 205 of the FPA is applicable here.[174]

96. In the background section of the June 26 Order, we noted that, in an April 25 Order,[175] we dismissed the complaints as to contracts entered into after June 20, 2001,

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[173] *Texaco*, 148 F.3d at 1096-97.

[174] Snohomish Reh'g Request at 30-31.

[175] April 25 Order, 99 FERC at pp. 61,383-84.

the date on which our West-wide mitigation went into effect.[176] California (by Complainants CEOB and the California Public Utilities Commission) sought but was denied rehearing on that issue in the July 23 Order.[177] Complain-
jection to our holding in the April 25 and July 23 Orders is an improper collateral attack on those orders and is, therefore, dismissed.

97. Complainants are concerned that in the June 26 Order we did not address matters it raised that were set out in Appendix C of that order. In the June 26 Order, however, we considered those arguments and found them unpersuasive. Moreover, in this Order, we again have considered and discussed Complain
Appendix C of the June 26 Order.

98. On rehearing, Complainants raise, for the first time, the argument that the ALJ erred by excluding the testimony of Stephen Sorey.[178] Complainants do not explain why they waited until after the June 26 Order was issued to raise for the first time on rehearing such a fundamental issue. The Commission generally looks with disfavor on parties raising on rehearing issues that should have been raised earlier.[179] Such behavior is disruptive to the administrative process because it has the effect of moving the target for parties seeking a final administrative decision. Absent good cause, not present here, we will not consider

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[176] June 26 Order at P 11.

[177] July 23 Order, 100 FERC ¶ 61,098.

[178] Complainants' Reh'g Request at 25.

[179] *Tenaska Power Services Co. v. Southwest Power Pool, Inc.*, 102 FERC ¶ 61,140 at P 14 (2003) (*citing Baltimore Gas & Electric Company, et al.*, 91 FERC ¶ 61,270, at p. 61,922 (2000); *Northern States Power Company (Minnesota), et al.*, 64 FERC ¶ 61,172, at p. 62,522 (1993); *Cities and Villages of Albany and Hanover, Illinois, et al.*, 61 FERC ¶ 61,362, at p. 62,451 (1992)). *See also* Rule 711(d)(2).

rehearing. Furthermore, since Complainants did not except to the ALJ's evidentiary ruling, its objections were technically waived under Rule 711(d)(2) of the Commis-

§ 385.711(d)(2) (2003).

99. Moreover, even if we were to consider Complain-

testimony was outside the scope of the proceeding because it related to a Sacramento Municipal Utility District long-term contract with Duke Energy Trading & Marketing, LLC not at issue here and thus should be stricken.[180] Furthermore, even if this evidence were included in the record, it would not change our decision. Complainants state that "Mr. Sorey testified that market participants at the time knew the spot market prices were inflated by dysfunction, expected such dysfunction to continue indefinitely, and specifically did no
December 15 Order would eliminate the effects of such
[181] These statements address the issue of whether there was dysfunction in the spot market, a fact not at issue in this proceeding. Therefore, it is not pertinent to our decision.

exclusion of evidence of market manipulation.[182] We reiterate our finding that the ALJ properly interpreted the Commission orders on this issue and appropriately ruled to exclude the evidence.[183] Additionally, Complainants had the opportunity to present evidence adduced in the 100-Day

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[180] *See* Transcript of Prehearing Conference at 331:6-22 (Oct. 30, 2002).

[181] Complainants' Reh'g Request at 25.

[182] Complainants' Reh'g Request at 25-26, 33-34.

[183] June 26 Order at P 24.

Discovery Proceeding[184] (California, by its Attorney General, and Complainants CEOB and the CPUC participated in the discovery process and submitted evidence in that proceeding) in which we allowed parties to conduct broad discovery into market manipulation during the western

[185] Complainants had a full opportunity in the 100-Day Discovery Proceeding to conduct the discovery they complain they did not have an opportunity to discover here. We note that, while Complainants have only generally proffered the evidence submitted in that proceeding without pointing to or discussing any particular evidence for our consideration, in making our determination here we considered all of the evidence submitted in that proceeding.

101. After carefully considering all of the evidence submitted by Complainants in this proceeding, the Staff Report,[186] and the evidence submitted in the 100-Day Discovery Proceeding, we found that Complainants did not sustain their burden under the public interest standard to justify the modification of these contracts.

102. There also is no merit to Complainants' claim that the June 26 Order is inconsistent with the April 25 Order.

Commission asked whether expectations of future dysfunctional prices inflated forward expectations so that the spot market dysfunctions could be said to have adversely impacted forward market prices, *invalidating those prices.*"[187]

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[184] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv.*, 101 FERC ¶ 61,186 (2002).

[185] Complainant's Reh'g Request at 4, 34, 37, 61-62; Snohomish Reh'g Request at 37-38.

[186] Complainants assert that we erred in acting on their complaints before Commission Staff completes its investigation into alleged market power and withholding by sellers. We find otherwise. This complaint proceeding is separate from the staff investigation. Nothing has been presented to show that it is necessary to hold our decision regarding the instant complaints until the separate staff investigation is completed.

with such evidence now, the Commission draws the conclusion that such evidence somehow *validates the unjust and unreasonable forward prices.* [188]

of our holding is incorrect. In the June 26 Order, we applied the public interest standard of review and found that Complainants did not meet their burden to justify modification of these contracts. Furthermore, in the June 26 Order, we explained that the causal effect of the spot market on forward bilateral prices would be relevant to contract modification only where the just and reasonable standard of review is applied.[189] Since the just and reasonable standard of review is not applicable here, that issue was not pertinent to our findings. Nothing in our determinations conflicts with our April 25 Order.

103. Complainants assert that, since they were wrongly prohibited from conducting any discovery concerning market manipulation and abuse, it is erroneous to exclude the evidence adduced in Docket Nos. EL01-10, IN01-3, EL02-113-000, EL02-114-000, EL02-115-000, EL02-80, EL02-81, EL02-82 and EL02-83 from the record in these proceedings. The Commission may reopen the record in its discretion where there is good cause.[190] The Commission views good cause as consisting of extraordinary circumstances, that is, a change in circumstances that is more than just material, but goes to the very heart of the case.[191] In deciding whether to exercise its discretion, "the Commission looks to whether or not the movant has demonstrated

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[187] Complainants' Reh'g Request at 27.

[188] *Id.*

[189] June 26 Order at P 37.

[190] 18 C.F.R. § 385.716 (2003).

[191] *CMS Midland, Inc.*, 56 FERC ¶ 61,177, at p. 61,624, *reh'g denied*, 56 FERC ¶ 61,361 (1991).

the existence of extraordinary circumstances that outweigh
[192] As
the Commission explained in
nize of course that changes have occurred since the close of the record. But such changes always occur. Yet litigation must come to an end at some point. Hence the general rule is that the record once closed will not be reopened."[193]

ants had a full opportunity in the 100-Day Discovery Proceeding to conduct the discovery into market manipulation during the western power crisis of 2000 and 2001 that they complain they did not have an opportunity to discover here. In the June 26 Order, the Commission found that the records of those other proceedings contain thousands of submittals, most of which are case-specific and not relevant to the issues in the instant proceeding and that the documents that could be relevant have been submitted in the 100-Day Discovery Proceeding.[194] The evidence that Complainants seek to introduce into the record will not change the outcome of this proceeding; therefore, we reject

The Commission orders:

rehearing of the June 26 Order are hereby denied for the reasons stated in the body of this order.

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[192] *East Texas Electric Coop., Inc. v. Central and South West Serv., Inc.*, 94 FERC ¶ 61,218, at p. 61,801 (2001) (denying reopening of record where movant sought to use actual data which became available after the close of the record in place of hypothetical data used at hearing).

[193] *Transwestern Pipeline Co.*, Opinion No. 238, 32 FERC ¶ 61,009 (1985), *reh'g denied*, Opinion No. 238-A, 36 FERC ¶ 61,175, at p. 61,453 (1986).

[194] June 26 Order at P 34.

request for clarification of the June 26 Order is hereby granted in part and denied in part for the reasons stated in the body of this order.

hearing of the June 26 Order is hereby denied for the reasons stated in the body of this order.

tion to dismiss the complainants in Docket Nos. EL02-60 and EL02-62 with prejudice as to El Paso is granted, as discussed in the body of this order.

By the Commission. Commissioner Massey dissenting with a separate statement attached.

Commissioner Brownell concurring with a separate statement attached.

William L. MASSEY, Commissioner, *dissenting*:

I dissented from the underlying order and nothing in

interest requires that the contracts at issue be reformed.

For the reasons stated in my dissent in the underlying

Nora Mead BROWNELL, Commissioner, concurring:

1. I am writing separately to reiterate a concern I raised about the June 26 Order: the rationale for concluding that modification of the contracts is subject to the public interest standard of review. When these cases were set for hearing, I noted that existing judicial case law seemed to indicate that the public interest standard applied to all of these contracts base

failure to explicitly reserve the buyer's right to seek unilateral changes under Section 206.[1] Nevertheless, I was willing to set the issue for hearing so that the parties and the ALJ could have an opportunity to further explore whether my understanding of the case law was accurate. Three ALJs have now independently come to the same conclusion: judicial case law establishes that in the absence of clear contractual language allowing unilateral contract modification, the party seeking the change must meet the public interest standard.[2]

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[1] *Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al.*, 99 FERC ¶ 61,087 (2002) (*citing Texaco Inc. v. FERC*, 148 F.3d

conclusion on this point and ended there the analysis of which standard to apply. That is what I am voting to do.

the finding of the applicable standard on an analysis of the extrinsic evidence that parties did or did not present at hearing. By doing so, the order ignores the law. The *Mobile-Sierra* doctrine is not an invention of the FERC that we are free to mold as we wish; it is a directive from the Supreme Court. Moreover, the order misses an opportunity to provide clarity and certainty to all market participants and leaves open the possibility that the Commission may order unnecessary fact-finding on the

ract abrogation cases.

1091, 1096 (D.C. Cir. 1998) and *Boston Edison Co. v. FERC*, 233 F.3d 60, 67 (1st Cir. 2000)).

[2] *Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al.*, 102 FERC ¶ 63,013 at P 28 (2003); *Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing, L.L.C., et al.*, 101 FERC ¶ 63,031 at P 27 (2002); and *PacifiCorp v. Reliant Energy Services, Inc., et al.*, 102 FERC ¶ 63,030 at P 18 (2003).

APPENDIX C

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[¶ 61,354]

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

v.

SELLERS OF LONG TERM CONTRACTS TO THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

DOCKET NOS. EL02-60-000 AND EL02-60-003

CALIFORNIA ELECTRICITY OVERSIGHT BOARD

v.

SELLERS OF ENERGY AND CAPACITY UNDER LONG-TERM CONTRACTS WITH THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

DOCKET NOS. EL02-62-000 and EL02-62-003

(CONSOLIDATED)

ORDER ON PARTIAL INITIAL DECISION, REMAINING SUBSTANTIVE ISSUES AND MOTIONS

(Issued June 26, 2003)

Before Commissioners: Pat Wood, III, Chairman; William L. Massey, and Nora Mead Brownell.

1. This proceeding involves complaints by which customers under certain long-term contracts sought to modify those contracts with more than twenty-four (24) sellers. As a result of withdrawals, only seven sellers remain in this proceeding. The Public Utilities Commission of the State of California (CPUC) and the California Electricity Oversight Board (CEOB) (collectively, "Complainants") allege that the prices, terms and conditions of long-term contracts entered into between the California Department of Water Resources (CDWR) and a group of sellers of energy are unjust and unreasonable and, to the extent applicable, not in the public interest. Complainants seek that the contracts be voidable, at the option of the State of California, or be abrogated.

2. In the order issued on April 25, 2002,[1] the Commission set the instant complaints for hearing. On January 16, 2003,[2] after an evidentiary hearing, the administrative law judge (ALJ) concluded that the applicable standard of review intended by the parties for the contracts at issue here

[3]

tracts at issue which did not contain explicit *Mobile-Sierra*[4]

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[1] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 99 FERC ¶ 61,087 (2002) (April 25 Order).

[2] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 102 FERC ¶ 63,013 (2003) (Partial Initial Decision).

[3] *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (*Mobile*); *FPC v. Sierra Pacific Power*, 350 U.S. 348 (1956) (*Sierra*); and *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div.*, 358 U.S. 103 (1958).

[4] *Mobile*, 350 U.S. 332; *Sierra*, 350 U.S. 348.

language. We also find that Complainants have not met their burden of proof under th
to justify the modification or abrogation of the contracts at issue in this proceeding. Thus, we deny the complaints. In denying the instant complaints, we have considered the evidentiary record developed in this proceeding, findings of

in Western Markets in Docket No. PA02-2-000 (Staff Report), and evidence submitted in the 100-Day Discovery Proceeding in Docket No. EL00-95, *et al.*[5]

4. Specifically, we affirm the ALJ's finding that the applicable standard of review for the contracts at issue here
. Before discussing the specific facts of the case before us, it is important to understand the historical context in
standard has been applied by the courts, and the legal parameters within which the Commission must address requests

review was first introduced by the U.S. Supreme Court in the 1956 *Mobile* case[6] and the concurrently decided *Sierra* case.[7] The U.S. Supreme Court held that, in order to justify modification of its contract, the seller in that case had to show that the contract rate was so low that it was contrary to the public interest. In the *Mobile* and *Sierra* decisions, the Court sought to mesh the respect for the sanctity of contracts under the Federal Power Act (FPA)[8] and Natural Gas Act[9] with the traditional scheme of regulation under

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[5] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv.*, 101 FERC ¶ 61,186 (2002) (November 20 Order), *order on clarification and reh'g*, 102 FERC ¶ 61,164 (2003) (February 10 Order).

[6] *Mobile*, 350 U.S. 332.

[7] *See Sierra*, 350 U.S. 348.

[8] 16 U.S.C. §§ 796 *et seq.* (2000).

[9] 15 U.S.C. §§ 717 *et seq.* (2000).

these statutes. The Court held that, where the public utility (or natural gas company) and its customer contracted for a particular rate and did not reserve for the seller the right to unilaterally propose a rate change, the utility cannot unilaterally (*i.e.*
rate under Section 205 of the FPA[10] to supersede the agreed-upon rate. The Court also ruled that the Commis-
[11] to alter the existing contract rate, after its acceptance by the Commission, is limited.[12]

5. In the *Sierra* decision, the Court gave examples of

allow the selling utility to modify its contract. The selling

rate is so low as to adversely
where it might impair the financial ability of a public utility to continue service, cast upon other consumers an excessive
[13]

6. Both *Mobile* and *Sierra* addressed seller challenges to contract rates alleged to be too low. In later cases, the *Mobile-Sierra* doctrine was applied to contracts containing rates that allegedly were too high.[14] The *Mobile* and *Sierra* cases were decided in a cost-based rate regime and consequently dealt with changes proposed to contracts that were already on file with the Commission. The application of the

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[10] 16 U.S.C. § 824d (2000).

[11] 16 U.S.C. § 824e (2000).

[12] *Boston Edison Co. v. FERC*, 233 F.3d 60, 64-65 (1st. Cir. 2000) (*Boston Edison*) (*citing Sierra*, 350 U.S. at 352-55; *accord Mobile*, 350 U.S. at 347).

[13] *See Sierra* at 355.

[14] *See, e.g., Public Service Commission of the State of New York v. FPC*, 543 F.2d 757, 798 (D.C. Cir. 1974).

Mobile-Sierra doctrine was later extended to contracts that were not on file with the Commission.[15]

7. In a more recent case involving a long-term, fixed-rate contract, the court held th

disparity or a benefit to the purchasing utility or its customers for a rate modification does not suffice, without

[16] In

PEPCO, the court also noted that the purchaser seeking a

evidence (beyond speculation)

that the only potential non-parties here, its ratepayers, were adversely affected by the existing rates; it did not, for example, even attempt to show how much if any of the rate disparity was passed on to PEPCO ratepayers rather than

[17] While PEPCO claimed an excessive burden on its customers and discriminatory impact from the disparity between the contract rates and the OATT rate charged by the same transmission provider, the court said that "other than pointing out that the contract

sented no evidence regarding how the contract rates are unduly discriminatory or excessively burdensome on PEPCO

.[18]

which holds that "the fact that a contract has become uneconomic to one of the parties does not necessarily render the contract contrary to [19]

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[15] *See, e.g., Richmond Power & Light v. FPC*, 481 F.2d 490, 493 (D.C. Cir. 1973) (holding that "the contract between the parties governs the legality of the filing. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid."). *Borough of Lansdale, Pennsylvania v. FPC*, 494 F.2d 1104, 1112 (D.C. Cir. 1974).

[16] *See Potomac Electric Power Company v. FERC*, 210 F.3d 403, 404 (D.C. Cir. 2000) (*PEPCO*).

[17] *Id.* at 408.

[18] *Id.* at 409.

8. Based upon our review of the evidence and the totality of circumstances, we conclude that the Complainants have failed to meet their burden of proof under the "public

the challenged contracts are not contrary to the public interest because the Complainants have failed to demonstrate that the contracts in question caused financial distress for the Complainants, threatening their ability to continue service, that the contracts cast an excessive burden on customers, that the contracts were unduly discriminatory to the detriment of other customers that are not parties to this proceeding, or that any other factors on this record demonstrate that the contracts are contrary to the public interest. At the time of contract execution, other alternatives were available to the Complainants; however, they chose to enter into the contracts in question, accepting market risks. Complainants benefitted from resales of the energy purchased under these contracts during the relevant period; however, after the drop in prices, Complainants became dissatisfied with their bargains and sought contract modification. The law is quite clear on that point. The fact that a contract becomes uneconomic over time does not render it contrary to the public interest. We, therefore, deny the instant complaints.

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[19] *See, e.g., Gulf States Utilities Company v. Southern Company Services, Inc., et al., Opinion No. 300*, 43 FERC ¶ 61,003, at p. 61,016, *reh'g denied, Opinion No. 300-A*, 43 FERC ¶ 61,394 (1988), *nom. Gulf States Utilities Company v. FERC*, 886 F.2d 442 (1989); *accord Soyland Power Cooperative, Inc. v. Central Illinois Public Service Company*, 51 FERC ¶ 61,004, at pp. 61,014-15 (*Soyland*), *dismissed as moot*, 52 FERC ¶ 61,149 (1990); *Public Service Company of New Mexico*, 43 FERC ¶ 61,469, at p. 62,152, , 45 FERC ¶ 61,034 (1988), . *San Diego Gas & Electric Company v. FERC*, 904 F.2d 727 (D.C. Cir. 1990) (San Diego).

9. This order is in the public interest because it balances effective rate regulation with respect for the sanctity of contracts, as dictated by the U.S. Supreme Court under the *Mobile-Sierra* doctrine.

I. Background

10. On February 25, 2002, Complainants filed separate, but virtually identical, complaints seeking to modify thirty (30) contracts.[20] The contracts at issue are long-term contracts between the California Department of Water Resources (CDWR) and more than twenty-four (24) sellers[21] of

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[20] The contracts which were set for hearing were listed in April 25 Order, 99 FERC at Appendix A and are provided herein in Appendix A.

[21] The complaints were filed against the following Respondents: Allegheny Energy Supply Company, LLC (Allegheny); Calpeak Project Companies; Calpine Energy Services, L.P. (Calpine); Clearwood Electric Company, LLC (Clearwood); Colton Power, L.P. (Colton), successor in interest to Alliance Colton, L.L.C. (Alliance); Constellation Power Source, Inc. (Constellation); Coral Power, L.L.C. (Coral); Dynegy Power Marketing, Inc. (Dynegy); El Paso Merchant Energy, L.P. (El Paso); Fresno Cogeneration Partners, LP (Fresno); GWF Energy LLC (GWF Energy); High Desert Power Project, LLC (High Desert); Imperial Valley Resource Recovery Company, L.L.C. (Imperial Valley) and Primary Power International (Primary Power), agents for Imperial Valley (collectively, IVRRC); Mirant America Energy Marketing, LP (Mirant); Morgan Stanley Capital Group, Inc. (Morgan Stanley); Pacificorp Power Marketing, Inc. (PPM); PG&E Energy Trading-Power, LP (PG&E Energy); Sempra Energy Resources (Sempra); Soledad Energy, LLC (Soledad); Sunrise Power Company, LLC (Sunrise); Wellhead Power Gates LLC and Wellhead Power Panoche LLC (Wellhead Companies); Williams Energy Marketing & Trading Company (Williams); and Whitewater Energy Corporation (Whitewater).

Complainants have withdrawn their complaints with the majority of the Respondents. Notices of withdrawal of complaints with prejudice energy. Complainants claimed that the prices, terms and conditions of these contracts are unjust and unreasonable and, to the extent applicable, not in the public interest. Complainants also alleged that these sellers obtained the prices, terms and conditions in the contracts through the exercise of market power in violation of the Federal Power

to the citizens and ratepayers of California.

11. On April 25, 2002, the Commission dismissed the complaints regarding the contracts that were entered into after June 20, 2001, "the date on which the Commission's West-wide mitigation went into effect, . . . since the effect of

[22] The Commission set for hearing the complaints regarding the contracts entered into before June 20, 2001. The Commission limited the evidentiary hearing to determining:

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were filed as to: (1) Whitewater on May 1, 2002; (2) Calpine on May 1, 2002 and May 2, 2002; (3) Constellation and High Desert on May 2, 2002 and May 6, 2002; (4) CalPeak Power—Midway LLC, CalPeak Power—Mission, LLC, CalPeak Power—Panoche LLC, CalPeak Power—Border LLC, CalPeak Power—Vaca Division LLC, CalPeak Power—El Cajon LLC and CalPeak Power—Enterprise LLC on May 20, 2002 and May 21, 2002; (5) Soledad on July 12, 2002; (6) GWF Energy on September 4, 2002 and September 5, 2002; (7) Alliance and Colton on September 30, 2002 and October 1, 2002; (8) PG&E Energy on October 3, 2002; (9) Sunrise on January 13, 2003. No motions in opposition to the notices of the withdrawal were filed, and the Commission took no action to disallow the withdrawal. Accordingly, pursuant to Rule 216 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.216(b) (2003), the withdrawals became effective at the end of 15 days from the date of the filing of the notices. The notice of withdrawal of the complaints as to Williams is granted, as discussed below.

[22] April 25 Order, 99 FERC ¶ 61,087.

> whether the dysfunctional California spot markets[23] adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue is warranted. The hearing will not address issues concerning the Commission's policies on granting market-based rate authority or on regulation of sellers with such authority. Further, if the judge concludes that modification of one or more of the contracts is warranted, the judge should not attempt at this stage to determine how those contracts should be modified.[24]

12. The Commission differentiated this evidentiary hearing from the staff investigation of potential manipulation of electric and natural gas prices in the West. The Commission stated that:

> By order issued on February 13, 2002 [in Docket No. PA02-2-000], the Commission directed a staff investigation of potential manipulation of electric and natural gas prices in the West. We are setting the instant contracts for hearing under Section 206 of the FPA based on the arguments that the dysfunctional spot markets in California caused long-term contracts not to be reasonable, whereas the investigation is looking at whether there was improper behavior by sellers that may have caused prices not to be reasonable.[25]

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[23] In this context, spot markets or spot market sales are sales that are 24 hours or less and that are entered into the day of or day prior to delivery. *See San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, 96 FERC ¶ 61,120, at p. 61,515 (2001); *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, 95 FERC ¶ 61,418, at p. 62,545 n.3 (2001).

[24] April 25 Order, 99 FERC at p. 61,384.

[25] April 25 Order, 99 FERC at p. 61,383, n.28

13. In addressing the standard of review to be applied to the contracts at issue, the Commission reiterated its longstanding policy of upholding the sanctity of contracts and stated that it would not modify market-based contracts absent extraordinary circumstances.[26] The Commission determined that the contracts that contained explicit *Mobile-Sierra* language would have to satisfy the *Mobile-Sierra* view to justify modification of the contracts. The parties whose contracts contained explicit *Mobile-Sierra* language include: Allegheny; Mirant; and Coral. The Commission ruled that it needed additional information in order to determine the applicable standard of review for the contracts that did not contain an explicit *Mobile-Sierra* provision. The parties whose contracts did not contain explicit *Mobile-Sierra* language include: El Paso; Dynegy; Morgan Stanley; and Sempra. In its January 23, 2002 Order on Rehearing, the Commission stated ring was established to, among other things, interpret the terms of [the contracts at issue] and to ascertain the intent of the parties at the time these [27]

14. In the July 23 Order, the Commission affirmed its dismissal of the complaints related to the contracts entered into after June 20, 2001, granted rehearing and dismissing complaints related to two qualifying facilities, and denied all other requests for rehearing and clarification.[28] By order

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[26] April 25 Order, 99 FERC at p. 61,383.

[27] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 100 FERC ¶ 61,098 at P 12 (2002) (July 23 Order).

[28] July 23 Order, 100 FERC ¶ 61,098. The Commission clarified that the complaints against Clearwood; Fresno; Wellhead Companies; PPM; and Sunrise were dismissed and that the complaints against Clearwood, Wellhead Companies, PPM and Sunrise were dismissed with prejudice. *Id.* at P 28. The Commission also dismissed the complaints against IVRRC and Soledad. *Id.* at P 19.

dated November 27, 2002, the Chief Administrative Law Judge suspended the proceeding as to Williams pending finalization of the parties' settlement agreement. Therefore, Complainants continue to pursue complaints against only seven sellers: Allegheny, Mirant, Coral, El Paso, Dynegy, Morgan Stanley, and Sempra.

15. Additional background on this proceeding is provided in Appendix B.

II. Discussion

A. *Procedural Matters*

1. *Notice of Withdrawal of Complaints as to Williams*

16. On January 13, 2003, Complainants filed a joint notice of withdrawal of their complaints with prejudice as to Williams and a joint motion requesting an order to approve

Practice and Procedure, 18 CFR § 385.216(b)(1) (2003), provides that the withdrawal of any pleading, such as a complaint, is effective at the end of 15 days from the date of filing of a notice of withdrawal, if no motion in opposition to the notice of withdrawal is filed within that period and the decisional authority does not issue an order disallowing the withdrawal within that period. If a motion in opposition to a notice of withdrawal is filed within the 15-day period, the withdrawal is not effective until the decisional authority issues an order accepting the withdrawal.[29]

17. PG&E filed a timely response to the notice of withdrawal requesting that the Commission clarify: (1) that Williams' settlement with Complainants and any other litigant does not compromise the claims of PG&E and other non-settling parties in Docket No. EL00-95, *et al.*, or elsewhere for energy and related products procured by and

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[29] 18 C.F.R. § 385.216(b)(2) (2003).

paid for by PG&E or that PG&E is found liable to pay for; and (2) that permitting this withdrawal would not constitute a ruling upon, or approval of, any provisions of the Williams' settlement with Complainants.

18. Rule 216 does not require the party seeking withdrawal of a pleading to show good cause; on the contrary, it requires good cause for disallowing the withdrawal. We find no such good cause here. Complainants and Williams have agreed to the withdrawal, and we find no reason to force Complainants and Williams to continue to litigate when they do not wish to do so. Therefore, we grant the withdrawal at issue. We clarify that our action with respect to the withdrawal of the complaints as to Williams will not affect in any way the amount of refunds that Williams may owe in Docket No. EL00-95, *et al.*, or elsewhere. We further clarify that we only address here the withdrawal of the complaints as to Williams and do not rule substantively on the proposed settlement agreement between Complainants and Williams.

2. *Allegheny Settlement Agreement*

19. On June 11, 2003, Complainants, Allegheny and Allegheny Trading Finance Company (collectively, the Settling Parties) filed a settlement agreement (Allegheny Settlement Agreement).[30] The Settling Parties requested that the Commission stay this complaint proceeding against Allegheny pending Commission action on the filing.

zation of their request as seeking a "stay," we will defer action as to Allegheny at this point pending our review of, and decision on, the proposed settlement.

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[30] On that same date, in Docket No. ER01-1847-001, Complainants and Allegheny filed an Amended and Restated Master Power Purchase and Sale Agreement between Allegheny Trading and CDWR (Amended and Restated Agreement).

3. *ALJ's Ruling Prohibiting Discovery on Market Power/Market Manipulation*

21. Complainants claim that the ALJ erred in prohibiting discovery on market power/market manipulation and in admitting evidence of alleged losses while preventing Complainants from conducting meaningful cross-examination. They assert that they sought this information to

Complainants state that, if the Commission concludes that Complainants have sufficiently proven their case without evidence of market abuse, then this issue is moot. Complainants argue that, if the Commission concludes otherwise, then the Commission should either: (1) remand for discovery and hearing on the issue of market abuse; or (2) presume that each Respondent (a) committed market abuse in a manner that contributed to the meltdown of the spot market and (b) had a basis for expecting that abuse of that type would enhance future spot market prices, the benefits of which they would not forego by signing forward contracts based upon expectations of lower prices.

22. Sellers argue that the ALJ properly excluded from the proceeding inquiry into market power and costs. Sellers claim that Complainants
have been allowed to submit evidence regarding alleged market manipulation constitutes a collateral attack on the April 25 Order in this case, which limited the scope of the proceeding to the exclusion of market power issues and was an improper attempt to seek interlocutory appeal. Sellers

by the inability to present evidence of market power. Sellers further state that, in any case, there is no basis in the record for the presumption that the expectation of the alleged continued existence of market power when market conditions were tight substantially inflated prices in the long-term bilateral markets.

23. Allegheny avers that Complainants' request to conduct discovery on allegations of market power are improper and irrelevant because Complainants have failed to show any connection between the dysfunctional Independent System Operator (ISO) and Power Exchange (PX) markets and the long-term bilateral market.

24. We find that the ALJ properly interpreted the
oceeding on the exclusion of market power/market manipulation information and properly prohibited discovery on this issue. Therefore, we af-

manipulation in more detail below.

4. *ALJ's Ruling Admitting Rebuttal Testimony of Mr. Koenig*

25. Complainants claim that the ALJ erred in admitting the Rebuttal Testimony of David Koenig to the extent it purported to quantify Alleghen
with CDWR. Complainants assert that they were prejudiced by the late production of the purported backup data to this testimony. Complainants contest
to permit Allegheny to submit testimony without backup data, refuse to strike the testimony when Allegheny had not provided any backup data by the date of the hearing and require Complainants to cross-examine Mr. Koenig using backup data that could not be read in the allotted time or used meaningfully in cross-examination. Complainants request that the Commission
Testimony on costs but allow it to be re[illegible]ied in the remedy phase of these proceedings after appropriate discovery.

26. Allegheny argues that the ALJ judge properly ad-

losses because the ALJ found that Complainants were not prejudiced in any way.

27. We defer to the ALJ's finding that Complainants were not prejudiced in any way by the admission of Mr. and, therefore, deny Complainants' request to strike. However, our ruling on the merits does not rely on this testimony, as discussed below.

5. *Request to Include in Record Market Manipulation/Abuse Evidence Submitted in Docket Nos. EL00-95, et al., and Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse*

28. On April 22, 2003, Complainants filed a Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse. Complainants have submitted a supplemental filing asserting the relevance of certain evidence adduced in Docket No. EL00-95, *et al.*, (100-Day Discovery Proceeding) to this proceeding. Complainants acknowledge that, at the time of their supplemental filing, the record of this proceeding had been closed, post-trial briefing had been completed and the entire record had been certified to the Commission. They state, however, that the Commis- *et al.*,[31] raised the question of whether the Commission intended to effectively r remand for discovery and hearing on the issue of market abuse in this proceeding.

29. The Commission did not intend to grant Complain-

10 Order.[32] The additional discovery and adducement of evidence granted in the Commi

Order[33] and subsequently clarified in the February 10 Order were limited to Docket No. EL00-95, *et al.*[34] The February 10 Order did direct parties to file an index for each other pending or proposed proceeding for which the filer claims its submission is relevant;[35] however, this directive was not an authorization for further discovery in the instant case or a finding that such information is relevant or admissible herein.

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[31] February 10 Order, 102 FERC ¶ 61,164.

[32] *Id.*

[33] November 20 Order, 101 FERC ¶ 61,186.

30. Complainants also request that the Commission reopen the record to admit or take official notice of:

Western Markets, Docket No. PA02-2-000 (March 2003) (Staff Report) and the evidence upon which the Staff Report is based; and (2) the evidence of market manipulation/abuse introduced in Docket Nos. EL01-10, IN01-3, EL02-113-000, EL02-114-000, EL02-115-000, EL02-80, EL02-81, EL02-82 and EL02-83.

31. At Oral Argument, Complainants argued that the evidence of market manipulation is relevant to the applica-

a contract with a seller who is found by the Commission to have participated in market manipulation should be abrogated because sellers that abuse market rules and standards of behavior should not be allowed to derive windfall profits from a traumatized market at the expense of customers. Complainants also suggested that a remand to the ALJ may be necessary to adduce additional evidence on market manipulation.

32. Coral responds that market power and manipulation are assumed and are not an issue in this proceeding because when the Commission set these complaints for hearing it assumed that the spot market was dysfunctional. Coral

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[34] February 10 Order, 102 FERC ¶ 61,164.

[35] *Id.* at p. 61,446.

argues that the Staff Report is not evidence upon which the Commission could base its decision because it has not been subject to discovery, cross-examination or rebuttal. Coral asserts that it is pointless to reopen the record to admit the statistical analysis in the Staff Report because, according to

is proceeding, the analysis documented in the Staff Report is not sufficiently powerful to detect the linkage, let alone "significant" linkage, between contemporaneous spot and forward prices. Coral contends that, even if the simple regression analysis in the Staff Report were powerful enough to detect the linkage between contemporaneous spot and forward prices, the results show low coefficients which do not establish an adverse effect of sufficient magnitude to warrant contract abrogation. Coral also disputes the interpretation of the slight correlation which is provided in the Staff Report.

33. Sellers argue that Complainants have not demonstrated that extraordinary circumstances exist to reopen

of the issues at the heart of this proceeding. They note that the Commission did not require Complainants either to prove that the ISO and PX spot markets were dysfunctional or to demonstrate the causes of that dysfunction, but rather were allowed to presume conclusively that those spot markets were dysfunctional. Sellers contend that it would be inappropriate for the Commission to take official notice

of market manipulation in several other dockets and the Staff Report are contested facts. Sellers assert that, even if the correlation analysis in the Staff Report were allowed into the record, it would not support or compel a conclusion that dysfunctions in ISO spot markets adversely and materially affected forward markets. Sellers argue that Complainants made a tactical decision not to submit a statistical correlation analysis at hearing and must live with the consequences of that decision. They point out that Complainants have not distinguished the correlation analysis in the Staff Report from any other expert evidence that Complainants might have submitted at hearing or shown that it enjoys any special evidentiary status by virtue of having been performed by members of th

would reward them with the opportunity to revisit their own tactical missteps. Sellers also note that the Staff Report only recommends remand to the presiding ALJ for

review. Sellers contend that

er and manipulation for other proceedings fall outside the scope of issues set for hearing in the April 25 Order and, even if considered, would not add substantive support to

official notice of the Staff Report findings and evidence submitted in the 100-Day Discovery Proceeding is moot because we have considered these findings and evidence as part of the record of this proceeding. As discussed below, we conclude that, even if we assume that the allegations and findings contained in the Staff Report and the 100-Day Discovery Proceeding were true, they would not be determinative of the issues in this proceeding. We deny Complainants' request to take official notice of or reopen the record to admit evidence submitted in other proceedings. The records of those proceedings contain thousands of submittals, most of which are case-specific and not relevant to the issues in the instant proceeding; the documents that could be relevant have been submitted in the 100-Day Discovery Proceeding.

6. *Motion to Lodge*

35. On January 29, 2003, CDWR filed a complaint against Allegheny Energy Supply Company, L.L.C. (Alle-

gheny Energy Supply) and Allegheny Trading Finance Company (Allegheny Trading) in the Superior Court of California, County of Sacramento. In its complaint, CDWR seeks to terminate its master sales contract and two confirmation letters that were assigned by Allegheny Energy Supply to Allegheny Trading based upon issues allegedly related to the assignment. Complainants request that the Commission consider this complaint within the context of this proceeding.

36. On December 4, 2002, the Commission authorized the assignment as consistent with the public interest and [36]

prior decision not to stay the approval of the assignment pending the resolution of the issues in this proceeding, we

lodge this complaint in this proceeding.

B. *Commission Determination Regarding Substantive Issues*

Findings of Fact and Conclusions of Law

37. In deciding whether the Complainants have met their burden of proof under th

of review to justify contract modification in these cases, we rely on the evidentiary record developed in this proceeding and also consider the findings of the Staff Report and evidence submitted in the 100-Day Discovery Proceeding. The Staff Report found that spot market distortions flowed through to forward power prices, particularly those for contracts of a short-term nature, *i.e.*, one to two years time to delivery. In addition, the Staff Report and the 100-Day Discovery Proceeding suggest that the California ISO and PX markets were subjected to market manipulation and gaming. The Staff Report conclusions and the 100-Day Discovery Proceeding documents are being contested in "show cause" proceedings involving allegations and/or findings of manipulation in the spot markets. However, even if we were to assume that these allegations and/or findings were true, they would not be determinative of the issues in the instant proceeding. The Commission has already concluded that the California ISO and PX spot markets were dysfunctional during the relevant period and that rates in those markets were unjust and unreasonable.[37] Evidence of market manipulation merely suggests yet another cause of the spot market dysfunctions and the unjust and unreasonable rates in the spot markets. However, a finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there

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[36] *Allegheny Energy Supply Company, et al.*, 101 FERC ¶ 61,278 (2002).

[38] As we have concluded, the contracts at issue in this proceeding do not provide for such a standard but rather evidence an intent that the contracts may be changed only pursuant to the "public interest" standard of

ntract modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms, and conditions are contrary to the public interest.[39] As fully discussed below, we conclude that the Complainants failed to make such a showing.

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[37] *See, e.g., San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services,* 93 FERC ¶ 61,121 at pp. 61,359-60 and 61,372 (2000) (November 1 Order); , 97 FERC ¶ 61,275, at p. 62;225 (2001).

[38] This conclusion is consistent with the Staff Report recommendation that, only for contracts subject to the "just and reasonable" standard of review, the Commission should send the Staff Report findings on the influence of the spot prices on forward prices to the ALJs to use as they see fit to resolve complaints. *See* Staff Report at V-19.

38. As determined by the Presiding ALJ and affirmed in this order, Complainants in this proceeding must meet the "public interest" standard in order to justify the requested contract modification. The ALJ concluded that Complainants failed to meet their burden of demonstrating that the contracting parties intended another standard of review to apply.[40]

39. The parties have failed to distinguish evidence required to demonstrate that a contract is not just and reasonable and that needed to demonstrate that the *Mobile-Sierra* been met. The parties spent most of the trial and their briefs attempting to demonstrate whether the contract rates were just and rea-

tals are provided in Appendix C. The arguments which are relevant have been addressed herein. They presented very little evidence relevant to the *Mobile-Sierra* standard of review. Based on the record, we conclude that Complainants have failed to demonstrate that any of the three prongs announced in the *Sierra* case has been met or that any other factor introduced into evidence warrants a finding that any of the contracts is contrary to the public interest and should be modified.

40. Based on the record, we conclude that there is no credible record evidence that the contracts at issue are placing Complainants in financial distress or that other customers will bear an excessive burden as a result of upholding the challenged contract

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[39] *See, e.g., Sierra*, 350 U.S. at 354-355.

[40] *See Partial Initial Decision*, 102 FERC ¶ 63,013 at P 43 and P 45.

central objectives was to achieve a portfolio that yielded a weighted average price no higher than $70/MWh, the average cost of energy supply
rates, as of January 2001.[41] In securing its contracts, CDWR achieved an overall portfolio that is diversified both in terms of energy products and durations[42] and reflects an average price of $70/MWh.[43] The average price for the first 5 years (May 2001 to December 2005) was estimated at $84/MWh and for the last 5 years (January 2006 to December 2010) was estimated at $60/MWh.[44] Complainants were unable to demonstrate that the contracts were priced above long-run competitive prices.[45]

41. Furthermore, Complainants have failed to present evidence showing that the challenged contracts are unduly discriminatory. In the past, the *Mobile-Sierra* doctrine has been applied to allegations of discriminatory or preferential treatment to the detriment of other purchasers who are not parties to the contract.[46] No such showing has been made by Complainants.

42. In addition to the evidence on the effects of the challenged contracts on the parties and customers, the ALJ has

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[41] Exh. CAL-51 at 10:24-11:3; Exh. AYE/SER-7 at 70:22-71:4 (Hart deposition); Exh. AYE/SER-11 at 64:11-66:2 (Nichols deposition); Tr. at 1258:14-1260:9; Exh. S-8 at 16:2-23.

[42] Exh. DYN-38 at 1.

[43] Exh. CAL-70 at 13 of Update of California Department of Water Resources Power Purchase Contract Efforts dated May 31, 2001 (May 31, 2001 CDWR Update); Exh. CAL-51 at 31:16-19; Exh. DYN-1 at 16:25-27.

[44] Exh. CAL-70 at 13 of May 31, 2001 CDWR Update.

[45] Exh. MAEM-25 at 6:20-9:22; Exh. COR-48; Exh. COR-50; Exh. CAL-163 at 1:22-2:7.

[46] *See Papago Tribal Authority v. FERC*, 723 F.2d 950, 953 n.4 (D.C. Cir. 1983) (Papago).

developed an extensive evidentiary record on the totality of circumstances preceding and following the execution of the contracts at issue.

43. Specifically, the record shows that CDWR had options and at least some bargaining power when it entered into this portfolio of contracts after often protracted negotiations. During late January and early February 2001, Governor Davis signed legislation that authorized CDWR to purchase, mostly through

10,000 MW.[47] The "net short" requirement is the difference between the amount of power that could be supplied by the California IOUs from their resources and the total demand for power at any given time.[48] Originally, to cover the net short positions, CDWR obtained almost all of the power it needed from either the spot market or "out of market."[49]

nounced that CDWR would issue a Request for Bids for Energy Purchase (RFB) and explained that the Governor

stabilize the market and drive the price of electricity down. . . . This is a key step in our efforts [to] keep the lights on in

[50]

45. On January 23, 2001, CDWR issued its first RFB.[51] CDWR sought bids at fixed prices for 69,000 to 100,000 GWh of on-peak energy annually and another 26,000 to

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[47] Exh. COR-1 at 8:1-7; Exh. COR-25 at 16:22-24; Exh. CAL-13; Exh. EPME-1 at 30:7-11; Exh. CAL-15.

[48] Exh. CAL-78 at 6:9-12; Exh. DYN-1 at 8:10-12.

[49] Exh. S-4 at 16:19-17:1.

[50] Exh. COR-1 at 8:7-13; Exh. COR-6; *accord* Exh. DYN-12 at 50:3-16.

[51] Exh. CAL-66; Exh. COR-25 at 9:21-22; Exh. EPME-28 at 2:11-12, 3:15-16.

40,000 GWh of off-peak energy annually.[52] CDWR received 99 bids in response.[53]

46. CDWR assembled a highly sophisticated procurement team to assist in CD [54]

47. On February 1, 2001, the California Legislature passed Assembly Bill 1 of the 2001-2002 First Extraordi-

[55] AB1X authorized, but did not require, CDWR to make power purchases to cover the Californ [56] Under AB1X, CDWR could enter into long-term power purchase contracts but could not provide any sovereign guaranty (i.e., its obligations were expressly not backed by the full faith and credit or taxing power of the State of California).[57]

48. On February 2, 2001, CDWR issued a second RFB requesting a mix of products and indicating that it was willing to buy from supply portfolios.[58]
RFB, this RFB also emphasized that bidders, and not

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[52] Exh. CAL-66; Exh. S-4 at 18:14-16.

[53] Exh. AYE-57.

[54] Exh. AYE-56 at 1; Exh. AYE-49 at 11:2-10; Exh. COR-1 at 10:16-11:20; Exh. COR-8; Exh. CAL-78 at 1:7-2:18; Exh. CAL-79; Exh. CAL-12 at 3:18-21; Exh. CAL-51 at 4:5-5:14, 1:3-19, 5:15-7:3; Exh. DYN-41 at 8:4-19; Exh. COR-67 at 222:22-223:6; Tr. at 1588:10-12, 1589:23-24, 1590:18-20; Exh. S-4 at 16:5-9; Exh. COR-41 at 5:12-6:7, 12:8-15; Exh. MAEM-1 at 16:4-8; Exh. EPME-56 at 4:18-5:1; Exh. EPME-28 at 5:7-9; Exh. EPME-35 at 1; Exh. COR-67 at 49:7-50:9; Exh. DYN-48 at 39:7-40:7; Exh. DYN-40 at 8:1-12; Exh. DYN-45 at 20:12-18, 21:13-22:6; *accord*, Exh. DYN-53 at 17:17-21.

[55] Exh. CAL-15; *accord*, Exh. S-4 at 15:21-16:2.

[56] Exh. CAL-15; Exh. DYN-1 at 9:11-16.

[57] Exh. CAL-15; Exh. CAL-66; Exh. CAL-67; Exh. EPME-56 at 3:14-15.

[58] Exh. CAL-67; Exh. S-4 at 18:18-19:3; Exh. COR-1 at 8:20-10:5; Exh. EPME-28 at 4:16.

CDWR, would be responsible for ensuring delivery to the specific congestion zone and that CDWR would assume neither transmission nor congestion risk and continued to require fixed pricing only.[59] The RFB did not indicate a preference for 1 to 3-year contracts or any other specific duration.[60]

ferent products to be offered up by prospective bidders.[61] CDWR received 114 bids in response.[62]

49. CDWR received a total of 213 offers to its first and second RFBs.[63] Within a few weeks, CDWR was able to assemble a portfolio of approximately 41 commitments, totaling approximately $43 billion.[64] This portfolio covered about 12,000 MW during the peak year.[65] In addition to the responses to the RFBs, CDWR negotiated with suppliers outside the RFB process.[66] There was competition among sellers to make offers to CDWR and, as a result, CDWR had choices and rejected numerous seller proposals.[67]

50. CDWR negotiated with the sellers on an individual basis and controlled what information they had regarding

[68] CDWR gained negotiating leverage with each agreement that it

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[59] Exh. CAL-67; Exh. COR-1 at 8:20-10:5; Exh. EPME-28 at 4:17-18.

[60] Exh. CAL-67; Exh. S-4 at 18:18-19:2; Exh. COR-1 at 8:20-10:5; Exh. COR-41 at 20:13-21:2.

[61] Tr. at 1253:10-11.

[62] Exh. AYE-58; Exh. CAL-67.

[63] Exh. AYE-57; Exh. AYE-58; Exh. DYN-40 at 6:17-18.

[64] Exh. S-4 at 19:18-19.

[65] Exh. S-4 at 19:19-20.

[66] Tr. at 1563:2-4; Tr. at 1564:16-25.

[67] Exh. AYE-80 at 196:15-25; Exh. AYE-61; Exh. EPME-28 at 11:1-3; Exh. COR-48 at 15:4-9.

[68] Exh. COR-63 at 2; Exh. AYE-51; Tr. 1561:14-1562:9; Exh. AYE/SER-1 at 37:18-21.

reached with the sellers.[69] Contemporaneous statements made by CDWR and the Governor of California indicate that they fully supported the price, terms and conditions in the contracts at the time they were executed.[70] On May 24, 2001, counsel and a negotiator for CDWR, prepared a mem-

in which he stated that "[e]ach power purchase agreement was the subject of often protracted negotiations. Frequently, sellers had to concede numerous points to obtain the terms and provisions they ultimately ended up with in

[71]

> I can't get terribly upset by these critics who say oh, by gosh, this is higher than what the price might be.
>
> turnip truck. I am not saying we took the shirt off their back. But I am saying that these were fair, negotiated, hard-fought deals.[72]

51. The rates, terms and conditions of the contracts and concessions made by the various parties during negotiations indicate that the contracts were not the product of unequal bargaining power.[73]

52. CDWR had options and did not lack bargaining power, given the number of parties who were interested in selling power to the State of California on a long-term

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[69] Exh. AYE-80 at 271:23-272:8; Exh. J-2 at 170:14-21; Exh. COR-48 at 15:4-7; Exh. AYE-52.

[70] Exh. DYN-37 at 1; Exh. COR-61 at 1; Tr. at 1496:7-15; Exh. COR-62; Exh. DYN-38; Exh. DYN-26 at 152:16-153:8; Exh. DYN-27 at 210:24-211:19; 215:15-217:2; 221:23-222:12.

[71] Exh. AYE-51 at NAV08-016238; Tr. at 1561:14-1562:18.

[72] Exh. DYN-26 at 152:16-153:8.

[73] Exh. DYN-1 at 41:4-15; Exh. DYN-1 at 19:9-14, 22:21-23:11; Exh. EPME-28 at 4:4-5, 8:7-9:13; Exh. SER-1 at 3:25-5:6.

basis.[74]

CDWR knew its actions would affect market prices.[75]

53. Although CDWR was viewed as more creditworthy than the California IOUs, its creditworthiness was still a concern to the marketplace.[76] Thus, the distribution of risks t symmetric between CDWR and the sellers under many contracts.[77] CDWR was, however, in a favorable bargaining position as a buyer of forward bilateral contracts because it was the largest, creditworthy bulk buyer in the State of California.[78] This fact gave CDWR a great deal of bargaining power over sellers of long-term contracts.[79] Negotiators on behalf of CDWR pressured sellers into doing deals with the State by indicat- would use the media against companies that failed to [80]

54. CDWR was able to demand and obtain many concessions from the Sellers, including obligating many, if not all, of the sellers to: (1) make immediate and/or near-term sales to CDWR at below-market prices; (2) assume transmission and congestion risk and provide high supply availability guarantees; (3) allow CDWR to eration; (4) assume the risk of changes in fuel prices; and (5) provide CDWR the option of choosing seller-supply and/or

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[74] Exh. COR-7 at 1; Exh. AYE-57; Exh. AYE-58; Exh. AYE-49 at 8:8-9; Exh. CAL-90 at 3:21-4:1; Exh. AYE-80 at 271:23-272:8;Exh. CAL-51 at 36:12-16; Exh. J-2 at 170:14-21; Exh. MAEM-1 at 17:1-3.

[75] Exh. CAL-90 at 3:21-4:1; Tr. at 1856:21-1857:16.

[76] Exh. EPME-1 at 53:5-54:2.

[77] *Id.*

[78] Exh. DYN-24 at 20:6-14; Exh. MAEM-1 at 15:26-16:4; Tr. at 2389:21-2390:4; Exh. SER-1 at 28:9-11.

[79] Exh. DYN-40 at 5:18-20; Exh. MAEM-1 at 16:14-17:3; Exh. AYE/SER-1 at 37:17-38:3.

[80] Exh. DYN-1 at 23:4-5; *accord*, Exh. MAEM-1 at 16:19-23, 16:25-17:3.

CDWR-supply of natural gas.[81] In certain of the contracts under review, even though the sellers proposed a fuel price indexing formula, CDWR insisted on a fixed price, thereby leaving sellers to bear the risk that fuel prices would increase in the future.[82]

55. CDWR rejected a number of contract offers for many reasons, including pricing, transmission constraints, credit issues and terms (e.g., length of contract, type of product).[83] CDWR rejected contracts with a large number of suppliers offering, in the aggregate, more than 10,000 megawatts for sale to CDWR.[84] There was give and take involved in the negotiations: CDWR would sometimes reject certain proposals and sellers would come back to CDWR with new proposals.[85]

Water Resources Power Purchase Contract Efforts."[86] Its objectives included: (1) creating a power purchase portfolio to reduce dependence on the spot market; (2) providing price stability and certainty; and (3) expediting construction of new power plants,[87] peaking facilities and distributed generation.[88] CDWR also sought to secure delivery of power in calendar year 2001.

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[81] Exh. COR-1 at 46:3-47:5; Exh. AYE-14 at 3:1-4:20; Exh. EPME-28 at 10:4-14; Exh. MAEM-1 at 13:5-18; Exh. MSC-1 at 6:16-7:2; Exh. SER-1 at 25:8-26:21; Exh. DYN-1 at 26:15-27:3.

[82] Exh. S-1 at 25:8-11.

[83] Exh. AYE-61 at DW-0015-0794; *accord*, Exh. AYE-80 at 227:12-14; Exh. AYE-59 at 90:11-13, 93:6-20; Exh. EPME-1 at 63:8-14; Exh. EPME-47 at 36:10-11.

[84] Exh. AYE-1 at 4:14-16.

[85] Exh. AYE-80 at 227:12-20.

[86] Exh. CAL-70.

[87] Exh. CAL-70 at 1; *see also*, Exh. COR-67 at 141:14-142:2.

57. CDWR took a deliberate and systematic approach to building its portfolio of power supply resources needed to cover the net-short requirements of the IOUs.[89] It began by negotiating commitments to buy around-the-clock power (7x24) and then began to shift its focus toward meeting on-peak requirements, which was followed with an effort to secure supply reductions in shoulder months.[90] Initially, CDWR wanted as much firm power under contract as it could obtain as soon as possible so it could immediately publicize these lower prices and reduce price volatility.[91] CDWR was looking for baseload, dispatchable, peaking, unit firm, and unit contingent products.[92] CDWR sought to obtain a portfolio of contracts, some with fixed prices and some with tolling provisions so that it could hedge its risk.[93]

58. CDWR sought products of 90 days, three years, five years, and 10 years in duration.[94] CDWR sought contracts for a 10-year period because Ca
in addition to getting existing energy in the [S]tate under

plants would require a longer period of time from which to get a reasonable price. [CDWR] did not want to be paying for a new plant in two, [or] three years. [CDWR] expected to see some contracts come in a 10-year period for that

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[88] Exh. CAL-51 at 29:3-30:6.

[89] Exh. COR-1 at 44:19-45:13; *accord*, Exh. MAEM-1 at 15:23-26.

[90] Exh. COR-1 at 44:19-45:13; Exh. COR-41 at 13:19-14:1.

[91] Exh. DYN-1 at 17:19-22.

[92] Tr. at 1559:23-1560:7; *accord*, Exh. COR-67 at 94:7-95:20; Exh. EPME-28 at 3:16-20.

[93] Exh. AYE-80 at 132:13-133:5.

[94] Tr. at 1559:18-22; *accord*, Exh. CAL-78 at 8:12-18; Exh. EPME-28 at 3:18-19; Exh. S-4 at 18:16-19:2; Exh. CAL-66; Exh. CAL-67.

[95] Most of the contracts entered into by CDWR to remedy its dependence on the spot market were for terms of ten years or more.[96] CDWR understood that long-term

ock . . . in solving the energy crisis."[97]

59. CDWR expected that supplies during summer 2001 could be scarce and, therefore, placed greater value on supply certainty, and sellers were offered incentives to bring supplies to the market.[98] CDWR was able to reduce its exposure to the spot market, stabilize prices and obtain a certainty of supply and portfolio of contracts.[99]

60. Based on the above, we conclude that Complainants have failed to demonstrate the financial impairment, excessive burden or undue discrimination described in *Sierra*

standard of review. Moreover, the contracts at issue were the result of choices voluntarily made by CDWR. The record also establishes that CDWR had better alternatives[100] and was not compelled to enter into the contracts at issue here.

61. Finally, there is nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation *specific to* the long-term contract negotiations resulting in prices and terms being challenged here.

62. Therefore, based on the record, it appears that Com-

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[95] Tr. at 1719:2-13.

[96] Exh. COR-25 at 4:1-6.

[97] Exh. DYN-12 at 49:17-23.

[98] Exh. EPME-47 at 26:15-27:19.

[99] Exh. CAL-78 at 5:6-13, 17:9-15.

[100] *See* Exh. AYE-57 and Exh. AYE-58.

satisfaction with the bargain. Commission and court precedent clearly establish that allegations that contracts have become uneconomic by the passage of time do not render them contrary to the public interest under the FPA.[101] The record clearly indicates that the challenged transactions
luntary choices. Therefore, because there is no evidence of unfairness, bad faith, or duress in the original negotiations, Complainants are not
[102]

63. For these reasons, we find that Complainants have failed to meet their burden
modification in this case is thus not warranted.

C. *Partial Initial Decision*

64. The ALJ concluded that the case law is clear that where a contract fails to specifically provide that the contract may be unilaterally altered, *Mobile-Sierra* requires that proposed changes meet
dard.[103] Under the *Mobile-Sierra* doctrine, the U.S. Su-

y be modified only if the contract is shown to be contrary to the public interest (*e.g.*, where the contract rate impairs the financial ability of the public utility to continue service, casts upon other customers an excessive burden, or is unduly discriminatory).[104] The ALJ noted that while the *Mobile-Sierra* doctrine arose in the context of a completely regulated environment, where, as here, the contracts were entered into under the become even more critical."[105]

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[101] *See PEPCO*, 210 F.3d at 409 (*citing Soyland*, 51 FERC at p. 61,013). *See also, Papago*, 723 F.2d at 953; *Sierra*, 350 U.S. at 354-355.

[102] *See PEPCO*, 210 F.3d at 410.

[103] *Partial Initial Decision*, 102 FERC ¶ 63,013 at P 28.

[104] *Sierra*, 350 U.S. at 355.

65. The ALJ reviewed the evidence in the record proffered by the contracting parties regarding the intent of the parties as to unilateral filing rights under the subject contracts aside from the express language of the contracts themselves.[106]
strates that the contracting parties did not intend to preserve their rights to make unilateral application to the Com-

Dynegy, El Paso, Morgan Stanley or Sempra contracts.[107]
he extrinsic evidence of
record indicates that the State had very little confidence in the Commission as an avenue for relief at the time these contracts were negotiated, that CDWR negotiated the sub-
ironment, and that for various
team focused almost exclusively on the pricing terms
[108] The

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[105] *Partial Initial Decision*, 102 FERC ¶ 63,013 at P 31 (quoting April 25 Order, 99 FERC at p. 61,383).

[106] *See* Partial Initial Decision, 102 FERC ¶ 63,013 at PP 36-42. The evidence of the contracting parties' intent on this issue is as follows: Exh. SER-1 at 34:6-36:14 (Niggli); SER-2; Exh. SER-32 at 6:17-7:5 (Niggli); Exh. SER-34; Exh. SER-35; Exh. SER-55; Exh. SER-56; Exh. DYN-1 at 12:10-12, 26:15-18, 31:23-32:24, 33:6-9, 33:10-34:5 (Lednicky); Exh. DYN-2 at EOB-DYN-1-0005286; Exh. DYN-40 at 16:3-6 (Lednicky); Exh. MSC-1 at 9:12-18 (Hamdan); Exh. S-1 at 6:15-8:17, 11:1-11, 15:10-19:2 (Forman); Exh. S-4 at 6:11-15:14 (Tingle-Stewart); Exh. CAL-181 at 308:12-25 (Freeman); Tr. at 1633:8-1637:6 (Hart); Tr. at 2292:16-2293:6 (Smith); Tr. at 2476:5-2482:6 (Forman); Tr. at 2486:8-21 (Forman); Exh. US-1 at 13:3-14:16 (Thomas); Tr. at 2143:13-2149:11 (Lednicky); Tr. at 2293:8-15 (Smith); Tr. at 2458:4-7 (Forman). *See id.* at PP 35-42.

[107] *Id.* at P 43 (*citing see, e.g.,* Exh. SER-1 at 34:10-26 (Niggli); Exh. DYN-1 at 33:10-34:5 (Lednicky)).

[108] *Id.* at P 43.

ALJ notes that, in fact, Semp

precluding unilateral application to the Commission for changes in rates, terms and conditions was an issue of importance to CDWR and that the parties agreed to language precluding the Commission from changing the contract rates, terms and conditions.[109] The ALJ concluded

the four remaining contracts and

of the evidentiary record in this proceeding supports a finding that the parties did not retain the right to unilaterally seek changes to their contracts, nor did the parties

[110]

66. The ALJ also noted that, on January 14, 2003, after the close of the evidentiary record in this proceeding, after the filing of Initial Briefs, and after issuance of the Commis-

[111]

edged that '[they] have not argued, or submitted evidence, to the effect that the absence of an explicit *Mobile-Sierra* provision in the remaining four contracts is itself a basis for not applying the *Mobile-Sierra* standard to those contracts. Accordingly, to the extent the *Mobile-Sierra* standard applies to the contracts with explicit *Mobile-Sierra* provisions,

[112] The

ALJ concluded that:

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[109] *Id.* (*citing* Exh. SER-1 at 34:6-26 (Niggli); Exh. SER-32 at 6:17-28 (Niggli)). For example, the ALJ found that, "with regard to the [Sempra] Agreement, [the President of Sempra] testified that, at CDWR's insistence, language was inserted into the [Sempra] Agreement to ensure that the Commission would not have the ability to review the rates, terms and conditions of the [Sempra] Agreement." *Partial Initial Decision*, 102 FERC at n.22 (*citing* Exh. SER-1 at 34:10-26 (Niggli)).

[110] *Id.* at P 45.

[111] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 102 FERC 61,025 (2003) (January 10 Order).

[112] *Id.* at P 44 (*citing* Answer of the California Public Utilities

> while the Complainants maintain their objection to the applicability of the *Mobile-Sierra* standard to any of the contracts at issue, Complainants concede that there is no basis in the record, under the Commissi these proceedings, for not applying the *Mobile-Sierra* standard to the Dynegy, El Paso, Morgan Stanley and Sempra contracts[, contracts at issue which did not contain explicit *Mobile-Sierra* language,] to the same extent it applies to the other contracts [with explicit Mobile-Sierra provisions] already before the Commission for determination.[113]

D. *Exceptions to Partial Initial Decision*

1. *Evidence of Market Manipulation and the Exercise of Market Power*

a. *Argument*

67. Complainants argue that the ALJ erroneously concluded that the Commission limited the scope of the evidentiary hearing to matters other than market manipulation and the exercise of market power. They state that the Commission correctly ruled that proof of the exercise of market power would not be required for Complainants to prevail; however, they contend that the Commission never ruled that such proof should not be allowed. Complainants contend that it would not have been appropriate for the Commission to restrict Complain

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Commission and California Electricity Oversight Board to Motion to Hold Briefing in Abeyance, January 14, 2003 (January 14 Answer)).

[113] *Partial Initial Decision*, 102 FERC ¶ 63,013 at P 52. *See also* January 14 Answer at P 7. However, as noted below, Complainants argue that here the "just and reasonable" standard and the *Mobile-Sierra* "public interest" standard effectively merge because it is contrary to the public interest to charge unlawful rates to the public.

exercise of market power. They assert that such proof would (1) provide direct evidence that sellers who were actively inflating spot market prices would expect to continue to do so and thus inflate forward prices; (2) rebut Respondents' argument that economic fundamentals alone explain the spot prices and forward prices during the California

"sanctity" of contracts should be upheld.

duct[114] stipulated to in Docket No. PA02-2-001 offers direct proof on the central issue that was set for hearing in this proceeding: the dysfunctional exercise of market power in the California PX spot market adversely affecting the long-term bilateral market by artificially inflating forward prices. They contend that such evidence disproves Respon-

market fundamentals during

May-June 2000 explain the price inflations that began in May-June 2000 and persisted through June 2001. They conclude that excluding such direct proof on the threshold issue was erroneous.

b. *Responses*

69. Trial Staff argues that this exception is merely an attempt to bolster Complainan

should have allowed discovery and presentation of evidence of market power and market manipulation at the hearing. It contends that the exception is misplaced since it is not pertinent to the subject matter of the Partial Initial Decision and Complainants have properly briefed this issue directly to the Commission in the second portion of this proceeding. Trial Staff states that Complainants have improperly presented evidence on the merits of an issue ruled outside the scope of the hearing and that the Commission should not countenance Complainant's reliance on extra-record evidence through their citation to the Reliant trader transcripts.

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[114] Complainants refer to Reliant's alleged withholding of approximately 2,000 MW of capacity from the market and falsely reporting to brokers that it needed to buy electricity for the third quarter of 2000 because it foresaw insufficient capacity in its own generation due to emissions (NOx) constraints and/or other capacity factor limitations.

70. Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley and Sempra (collectively, Sellers)[115] argue that the Partial Initial Decision did not open the door for Complainants to restate objections to prior rulings or to submit irrelevant and prejudicial evidence into the record that closed on December 12, 2002. Sellers note that this issue is not a legitimate exception because it falls outside the scope of issues to be addressed by the ALJ as set forth not only in

uary 10, 2003 order. Sellers request that the challenge to rulings on the scope of the hearing in any of Complainants briefs be rejected as an impermissible collateral attack on

scope of the evidentiary hearing to matters other than market manipulation and the exercise of market power. They argue that objections to the limitation on the scope of the hearing should have been sought through rehearing of the April 25, 2002 order. Sellers also contend that Complainants challenge to the prior rulings of the Chief Judge and ALJ regarding the scope of the proceeding is an untimely, improper attempt to seek interlocutory appeal of such rulings.[116]

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[115] Allegheny, Coral and Mirant joined in Sellers' Brief Opposing Exceptions for the purpose of responding to assertions concerning the content and/or applicability of the *Mobile-Sierra* standard of review, market power and market manipulation.

[116] *Citing Pacific Gas Transmission Company*, 56 FERC ¶ 61,430, at p.

c. *Commission Determination*

71. This exception is not pertinent to the subject matter of the Partial Initial Decision which only addressed the applicable standard of review. However, our consideration of market manipulation and market power evidence is discussed above. Therefore, we dismiss this exception.

2. *Application of Mobile-Sierra to Buyers and Sellers*

a. *Argument*

72. Complainants reassert their contention that *Mobile-Sierra* should not apply to any of the contracts at issue because Complainants were not the contracting parties. However, even if Complainants were actual parties to the contracts, they argue that different factors apply when the *Mobile-Sierra* applied to a buyer, rather than a seller. They contend that, when it is alleged that rates are too high and the buyer has agreed to pay too inquiry asks whether the

in a case such as this one, where the rates are directly borne by the public because the buyer was a state agency purchasing power solely for the benefit of the public, the *Mobile-Sierra*

contrary to the public interest to charge unlawful rates to the public.

b. *Response*

73. Trial Staff and Sellers state that Complainants do not take issue with the application of the "public interest" standard to the contracts at issue, but rather with the test to be applied when dealing with a buyer, not a seller, under

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62,537 (1991); *McDowell County Consumers Council, Inc. v. American Elec. Power Company*, 26 FERC ¶ 61,042, at p. 61,140 (1984).

the *Mobile-Sierra* doctrine. They also note that the ALJ properly cited to *San Diego Gas & Electric Company v. Public Service Company of New Mexico*[117] for the holding that a buyer is subject to the "public interest" standard, notwithstanding that the contract was silent as to the

dard was applied to buyers
without collapsing that standa
[118] emphasizing two cases in which a
buyer's request to modify a contract was rejected.[119]

74. Sellers argue that Comp
they should be subject to a less strict standard of review
does not comport with judicial precedent which dictates
[120]
Sellers also respond that Complainants' allegation that the
not consider the effect on
ratepayers is unsupportable since this effect is considered in the first and second prong of the test.

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[117] *San Diego Gas & Electric Company v. PSC of New Mexico*, 91 FERC 61,233, at pp. 61,852-53 (2000) (June 1 Order).

[118] *San Diego*, 904 F.2d at 730-32; April 25 Order, 99 FERC at p. 61,383, Appendix A; July 23 Order, 100 FERC at p. 61,394; *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 101 FERC ¶ 61,293, at p. 62,175 (2002) (December 17 Order); *Nevada Power Co., et al. v. Enron Power Marketing, Inc., et al.*, 101 FERC ¶ 63,031, at p. 65,277, (2002); *PEPCO*, 210 F.3d at 412.

[119] *San Diego*, 904 F.2d at 730-32; *PEPCO*, 210 F.3d at 412.

[120] Sellers note that there have been cases in which the Commission has applied a more flexible public interest standard; however, those circumstances involved cases in which the Commission had never had an opportunity to review the disputed contracts and the Commission sought to apply a more flexible public interest standard to protect non-parties. *See Northeast Utilities Serv. Co.*, 66 FERC ¶ 61,332 (1994) (*Northeast Utilities*); *Florida Power & Light Co.*, 67 FERC ¶ 61,141 (1994) (*FP&L*).

c. *Commission Determination*

75. Complainants appear to argue that, because they are not parties to the contracts at issue and they filed these complaints on behalf of California customers, the Commission should apply the more fl

dard developed in the *Northeast Utilities*[121] line of cases.

76. In the April 25 Order[122] and the July 23 Order,[123] the

In those orders, the Commission stated that the State of California entered into the contracts at issue through one of its many agents, CDWR.[124] The Commission does not believe that a different standard of review should apply because these contracts are being challenged by other agents of the State of California, namely CEOB and CPUC.[125] The Commission stated that, in performance of its duty of administering the FPA, it views the State of California, CDWR, CPUC, and CEOB as one and the same entity that, in this case, acted as a buyer in the energy markets.[126] Accordingly, we deny this exception.

3. *Countervailing Policy Goals and Appropriateness of Modification*

a. *Argument*

77. Complainants assert that the Partial Initial Decision

reasonable rates. They also contend that the *Mobile-Sierra* principles would not be compromised if the instant contracts are modified because: (1) the contracts were signed during an extraordinary market meltdown; (2) the contracts were signed after the Commission gave notice in its December 15 Order that it was concerned about forward prices and would entertain after-the-fact challenges; and (3) the requested remedy would allow every seller to recover all its legitimate costs, plus a reasonable rate of return. They conclude that the remedy requested in these extraordinary circumstances would not create precedent that would impede contract formation in the normal course.

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[121] *Northeast Utilities*, 66 FERC ¶ 61,332.

[122] April 25 Order, 99 FERC at pp. 61,382-383.

[123] July 23 Order, 100 FERC at p. 61,396.

[124] April 25 Order, 99 FERC at pp. 61,382-383; July 23 Order, 100 FERC at p. 61,396.

[125] *Id.*

[126] July 23 Order, 100 FERC at p. 61,396.

b. *Response*

78. Trial Staff notes that the ALJ did not determine whether the contracts should be modified. It states that the ALJ merely noted that, if the parties have not preserved their rights to seek unilateral modifications, then the *Mobile-Sierra* standard of review serves to protect the expectations of the contracting parties that their negotiated agreement will not be modified unless in the public interest.

policy considerations cited by the ALJ are unjustified because they flow directly from judicial and Commission precedent.[127]

c. *Commission Determination*

80. The policy considerations raised here by Complainants were beyond the scope of the Partial Initial Decision. The ALJ was not directed by the Commission to address whether specific contracts should be modified and therefore did not do so. We addressed these policy considerations above, however.

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[127] *Citing* Partial Initial Decision at P 45 n.25 (*citing Texaco Inc. v. FERC*, 148 F.3d 1091, 1095 (D.C. Cir. 1998) (*Texaco*); *Town of Norwood v. FERC*, 202 F.3d 392, 400 (1st Cir. 2000); *Papago*, 723 F.2d at 953); November 1 Order, 93 FERC at p. 61,359.

4. *Application of the* Mobile-Sierra *Standard to Market-Based Rate Contracts*

a.

i. *Argument*

81. Snohomish argues that, because in the market-based rate context there is no initial review and approval of contract provisions such as price and term, the protections guaranteed by the FPA which ensure that all rates, terms and conditions of service are just and reasonable[128] are

market-based rate contracts.[129]

ii. *Response*

82. Trial Staff points out that, after determining that none of the Respondents possessed the ability to exercise market power, the Commission granted all of the Respondents in this proceeding market-based rate authority. Trial Staff argues that, therefore, by definition the rates, terms and conditions of the actual contracts that Respondents negotiated in the market place are deemed just and reasonable. Trial Staff concludes that the need for prior Commission approval of these contracts has been met because the rates, terms and conditions included within these agreements are presumed just and reasonable. Trial Staff claims that Snohomish is taking issue not only with the determination that the *Mobile-Sierra*

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[128] *Citing* 16 U.S.C. §§ 824d, 824e (2000).

[129] It asserts that, in *FP&L,* 67 FERC at p. 61,398, the Commission rejected the notion that it is or should be bound by the "public interest" standard when it initially reviews a contract. *See also, Northeast Utilities*, 66 FERC at p. 62,082; *Pennsylvania Electric Co. v. FERC,* 11 F.3d 207, 210 (D.C. Cir. 1993).

standard applies but also with the validity of market-based rates generally.

83. Sellers argue that Snohomish misapprehends and/or seeks to collaterally attack notice and filing requirements and how they apply to market-based rates. They state that the application of the *Mobile-Sierra* doctrine cannot depend on the filing and approval of a contract if no such approval is available from, much less required by, the Commission. Sellers contend that Snohomish fails to discretion to authorize and implement its own filing requirements[130] and the sound policy decision behind the

based rate contracts to undergo additional review before they can become effective.[131]

iii. *Commission Determination*

84. As noted in *GWF*,[132] if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate authority, it would make the original grant of market-based rate authority (*i.e.*, the original acceptance of the market-based rate tariff) a pointless exercise of no value to anyone. A new determination concerning the justness and reasonableness of a long-term service agreement is therefore unnecessary because such a determination has, in effect, already been made in the acceptance, and continuing effectiveness, of the market-based rate tariff pursuant to which a long-term service agreement

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[130] *Citing* 16 U.S.C. § 824d(c) (2000).

[131] *Citing GWF Energy LLC and Southern Co. Servs. Inc.*, 97 FERC ¶ 61,297, at p. 62,391 (2001), *reh'g denied, GWF Energy LLC*, 98 FERC ¶ 61,330 (2002) (*GWF*), *appeal docketed sub nom. Public Utilities Commission of California v. FERC*, No. 02-1108 (D.C. Cir. filed Apr. 12, 2002), dismissed June 18, 2002.

[132] *GWF*, 98 FERC at pp. 62,390-91.

is filed. The required mechanisms for ensuring that market-based rates are just and reasonable are in place: (1) prior to selling at market-based rates, sellers are required to file their proposed market-based rate tariffs for Commission review and demonstrate that they lack generation and transmission market power and control no other barriers to entry and that there is no affiliate abuse or reciprocal dealing; and (2) sellers file triennial updates thereafter. If Snohomish were correct, no contract made

contractual expectations as envisioned by the U.S. Supreme Court in *Mobile-Sierra*. Moreover, the Commission has expressly rejected this proposition[133] and expressly excluded from the subjects set for hearing issues concerning granting market-based rate authority or on regulation of sellers with such authority.[134] Accordingly, we reject this exception.

b. *Authority to Approve Market-Based Rates*

i. *Argument*

85. Snohomish claims that the Partial Initial Decision exceeds the Commission's authority to approve market-based rates by allowing rates that are unreasonable, imposing on customers the burden of proving that markets were not competitive, and presuming that market-based rates alone produce competition which results in virtually any price falling within the zone of reasonableness.

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[133] *See GWF*, 98 FERC at pp. 62,390-91; *State of California ex rel. Lockyer v. British Columbia Power Exchange Corp.*, 99 FERC ¶ 61,247, at p. 62,063 (2002), *reh'g denied*, 100 FERC ¶ 61,295 (2002), *appeal filed sub nom. State of California v. FERC*, No. 02-73093, 9th Cir.

[134] April 25 Order, 99 FERC at p. 61,384.

ii. *Response*

86. Trial Staff notes that the ALJ recognized that valid, market-based rates are just and reasonable rates unless the public interest requires that they be changed. Trial Staff also points out that the FPA and Natural Gas Act (NGA) place the burden of proof on those advocating a change in the status quo. Trial Staff argues that, because Complainants seek to abrogate or modify the instant contracts, they bear the burden of proof which the Commission has stated request to modify contracts which were entered into voluntarily in a market-based rate environment.[135]

iii. *Commission Determination*

87. Market-based rates are authorized based upon a finding that a seller lacks market power and that, therefore,

rates in a specific contract may become unjust and unreasonable. If the contract rates become unjust and unreasonable (*i.e.*, not what a competitive market would produce) and the contract does not pe review, the contract rates over the life of the contract may be changed only if found to be contrary to the public interest pursuant to the *Mobile-Sierra* doctrine.[136]

88. In this proceeding, CDWR adopted a contractual arrangement under which the Commission maintains the ability under Section 206 of the FPA to replace rates only if they are contrary to the public interest. As stated in the April 25 Order, the burden of pr burden" given that the contracts were entered into voluntarily in a market-based rate environment.[137] Complainants

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[135] April 25 Order, 99 FERC at p. 61,383.

[136] *Sierra*, 350 U.S. at 355.

[137] April 25 Order, 99 FERC at p. 61,383.

shown that the rates in the instant contracts are contrary to the public interest. Therefore, we dismiss this exception.

c. *Legislative History of the FPA*

i. *Argument*

89. Snohomish argues that the legislative history of the FPA indicates that Congress did not intend to grant private contracts, including independently negotiated bilateral contracts, immunity from the Commission's oversight responsibilities. Snohomish also contends that the Commis-
and the legislative history of the Energy Policy Act of 1992 (Energy Policy Act) indicate that, even though Congress intended to promote competition in the industry and the electricity markets have become more competitive than when the FPA was first enacted, Congress did not intend to alter the
206 authority to modify or terminate jurisdictional contracts and/or rate schedules.[138]

ii. *Response*

90. Trial Staff states that private contracts are not immune from Commission oversight. It argues that the Commission would order an appropriate remedy if the contracts were not in the public interest because they imposed an excessive burden on customers, were unduly discriminatory or were entered into as a result of market power or market manipulation. Trial Staff contends that the issue is not whether the Commission will perform its regulatory duties but whether Complainants have carried their burden of proof to warrant contract reformation.

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[138] *Citing City of Bedford, Virginia, et al. v. Appalachian Power Company*, 87 FERC ¶ 61,037, at p. 61,139 (1999).

iii. *Commission Determination*

91. We agree that private contracts are not subject to immunity from the Commission's oversight responsibilities. Indeed, the *Mobile-Sierra* doctrine recognizes that, even if parties agree to limit their unilateral rights to amend contracts, they cannot elimin
sible right to replace rates that are contrary to the public interest.[139] However, under long-standing court precedent, the fact that a contract rate may no longer be just and reasonable does not equate to a demonstration that the contract is contrary to the public interest. We also agree that nothing in the Energy Policy Act altered the Com-

The Commission is following the requirements of Sections 205 and 206, as interpreted by the *Mobile-Sierra* line of cases, in analyzing the evidence before us. The fact is that Complainants have failed, based upon this record, to show that the contracts at issue are contrary to the public interest. Therefore, we deny this exception.

5. *Implied Waiver of Section 206 Rights*

a. *Argument*

92. Snohomish claims that
parties can waive Section 206 rights by implication is contrary to established precedent.[140] It also argues that the ALJ's reliance on *San Diego Gas & Electric Co. v. Public*

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[139] *See Papago*, 723 F.2d at 953. *See also, id.* at 954 ("The Commission's obligation to insure that rates do not violate that prescription [that they are in the public interest] is imposed for the direct benefit of the public at large rather than (like the prescription of just and reasonable rates) for the direct benefit of the seller and purchaser; and it therefore cannot be waived or eliminated by agreement of the latter.")

[140] *Citing Sithe/Independent Power Partners v. Niagara Mohawk Power Corp.*, 76 FERC ¶ 61,285, at p. 62,458 (1996); *Boston Edison*, 233 F.3d at 67.

Service Co. of New Mexico[141] is misplaced because: (1) the Commission there concluded that the parties had contemplated the possibility of a rate decrease but prohibited the filing for such a decrease as an express and integral part of the bargain struck by the contracting parties; and (2) the contract there had been approved by the Commission as just and reasonable, and the Commission found that

review of a contract upon initial filing.

b. *Response*

93. Trial Staff and Sellers responds that the case law is unambiguous that, when contracts are negotiated in the absence of clear contractual language allowing unilateral contract modification under Section 206, the party seeking

lic interest" standard.

c. *Commission Determination*

94. The Complainants in this case were given an opportunity to provide evidence demonstrating the parties' intent

at issue. Instead, they argued at hearing as well as in their post-hearing briefs that the

rd merge because it is contrary to the public inter[illegible] to charge unlawful rates to the public. The Commission and court precedent establish that

standard of review are two separate standards and thus cannot be collapsed into one standard of review.[142] The weight of the record evidence on the circumstances surrounding execution of the challenged contracts demonstrates that the parties intende

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[141] June 1 Order, 91 FERC ¶ 61,233.

[142] *See, e.g., Sierra* at 354-5 (1956) and *Southern California Water Co. v. Southern California Edison Co.*, 90 FERC ¶ 61,287 (2000).

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long-term bilateral markets. Sellers claim that Complainants did not present any empirical or statistical analysis attempting to prove that the dysfunctional ISO spot markets in any way affected the long-term bilateral markets.

Sellers contend that Compla

not present any analysis of ISO spot markets, looking instead at bilateral spot markets. Sellers state that the expert failed, therefore, to provide substantive evidence concerning the relevant spot markets.

Sellers note that the only empirical analysis that Complainants offered in their direct case when corrected for numerous and admitted errors showed that the rates in the challenged contracts do not exceed long-term competitive prices.

Sellers contest Comp emphasis on the supposedly sudden and dramatic two-week decline in bilateral spot and forward prices during late May and early June 2001 relied upon to demonstrate that spot market dysfunction adversely affected forward power prices.

factually incorrect when viewed in the context of overall price trends throughout the spring of 2001 and, therefore, is not dispositive.

Sellers argue that none of the external factors cited by Complainants' expert support his theory that sudden

ve[illegible]ments, explained the supposedly sudden and dramatic collapse in spot and forward prices better than market fundamentals.

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for its discussion of the applicable standard of review, to a joint initial hearing brief filed by Allegheny, Coral and Mirant on that same date. Therefore, the following discussion of their initial hearing briefs will refer to these Respondents collectively as "Sellers."

dard of review to apply to the contracts at issue. On this

that the "public interest" standard of review applies to these particular contracts and deny exceptions on this issue.

6. *Satisfaction of the Mobile-Sierra Standard*

a. *Argument*

95. Snohomish contends that
dard is met here because of the devastation inflicted on electric customers across the West by the rates, terms and conditions contained in the long-term contracts that grew out of the crisis. It claims that evidence presented by Complainants establishes that the expectation that the California spot markets would continue to spiral out of control indefinitely forced CDWR to accept long-term contracts at prices and with terms and conditions far less favorable than would have resulted from a dysfunctional market. Snohomish concludes, therefore, that customers will be forced to bear excessive burdens arising from the market dysfunction into the future unless the Commission modifies these contracts.

b. *Response*

96. Trial Staff points out that the determination of
standard has been met was beyond the scope of the Partial Initial Decision.

c. *Commission Determination*

97. In its January 10 Order, the Commission limited the scope of the Partial Initial Decision to a determination of which standard of review to apply to contracts without explicit *Mobile-Sierra* language and stated that the Commission would determine whether the appropriate standard had been met based upon the evidence presented. We discuss above whether the "public interest" standard has been

met and conclude that Complainants have not met their burden of proof.

7. *Alleged Unlawful Deregulation of Electricity Sales*

a. *Argument*

parties' Section 205 and 206 rights to unilaterally modify the contract constitutes the unlawful deregulation of electricity sales because it allows sellers of electricity to collect rates and charges that are not just and reasonable, in contradiction with the express words of the FPA.

b. *Response*

99. Trial Staff counters that, while Sections 205 and 206 require that all rates be just and reasonable, that requirement cannot be read in isolation when a freely-negotiated contract prohibits or limits changes to that contract. It contends that the only in

to the language of such a contract, the established *Mobile-Sierra* doctrine and the intent of the parties is that the contract price is the just and reasonable rate. Trial Staff argues that a contract price based upon market-based rates would be just and reasonable if it is consistent with the seller's market-based rate authority. It claims that such a just and reasonable rate may become unjust and unreasonable only if one of the three prongs of the "public interest" test is met. It concludes that other measures of justness and reasonableness, such as traditional cost-of-service calculations, do not apply, unless the "public interest" test is met first.

be an arbitrary and capricious abandonment of years of decisions upholding contract sanctity and applying the buyers seek to abrogate fixed-rate contracts.

c. *Commission Determination*

101. As discussed above, if rates become unjust and unreasonable (*i.e.*, not what a competitive market would produce over the life of the contract) and the contract does

changed only if found to be contrary to the public interest pursuant to the *Mobile-Sierra* doctrine.[143] Under the contracts at issue, the Commission maintains the ability under Section 206 to replace rates that are contrary to the public interest; however, it does not have the power to replace rates that are unjust, unreasonable, or unduly discriminatory or preferential to the detriment of the contracting purchaser.[144] Complainants have not shown that the rates in the instant contracts are contrary to the public interest. Therefore, we deny this exception.

The Commission orders:

(A) The Partial Initial Decision is hereby affirmed, as discussed in the body of this order.

(B) The complaints are hereby denied.

tion requesting order to approve withdrawal of complaints with prejudice as to Williams is granted, as discussed in the body of this order.

tion to reopen the record is hereby granted in part and denied in part, as discussed in the body of this order.

ke official notice is hereby denied, as discussed in the body of this order.

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[143] *Sierra*, 350 U.S. at 355.

[144] *See Papago*, 723 F.2d at 953.

lodge is hereby denied, as discussed in the body of this order.

Chairman Wood concurred in part with a separate statement attached.

Commission Massey dissented with a separate statement attached.

Commission Brownell concurred with a separate statement attached.

Appendix A

List Of Contracts Set For Hearing

Public Utilities Commission of the State of California v. Sellers of Long Term Contracts to the California Department of Water Resources

Docket Nos. EL02-60-000 and EL02-62-000

I. Contracts for which the issue of the applicable standard of review was summarily decided:

2/21/2001

Allegheny Energy Supply Company, LLC—3/23/2001

Mirant Americas Energy Marketing, LP—5/22/2001

II. Contracts for which the issue of the applicable standard of review was set for hearing:

Seller's Name—Contract Date

Imperial Valley Resource Recovery Company, L.L.C.

Alliance Colton, LLC—4/23/2001

Appendix B

The evidentiary hearing began on December 2, 2002 and concluded on December 12, 2002.

On December 17, 2002, the Commission denied Alle- r summary dismissal of the complaints regarding its contracts which had been filed on October 29, 2002.[145] To expedite resolution of the proceeding as to Allegheny and other parties whose contracts contained explicit *Mobile-Sierra* provisions, the Commission directed the ALJ to omit the initial decision on this issue and certify the record directly to the Commission. On December 24, 2002, the ALJ certified the record of this portion of the proceeding directly to the Commission, as directed, and proceeded to evaluate the record for the purpose of preparing an initial decision on the contracts of the remaining sellers.[146]

On January 10, 2003, in response to motions for partial summary disposition on the applicable standard of review

long-term contracts with CDWR, the Commission directed the ALJ to determine the applicable standard of review for the contracts which did not contain explicit *Mobile-Sierra* language and, if the ALJ found the "public interest" standard applied, to certify the record of those contracts directly to the Commission for consideration of all remaining issues in the case.[147] On that same date, initial post-trial briefs were filed by Complainants, Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley, Sempra, Respondents jointly, Trial Staff and Universal.

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[145] December 17 Order, 101 FERC ¶ 61,293.

[146] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 101 FERC ¶ 63,034 (2002). *See also*, Errata Notices dates 12/31/02 and 1/10/03.

On January 13, 2003, Complainants filed a joint notice of withdrawal of their complaints with prejudice as to Williams and a joint motion requesting an order to approve such withdrawal. On January 28, 2003, Pacific Gas and Electric Company (PG&E) filed an answer to the notice of withdrawal.

On January 16, 2003, the ALJ issued a partial initial

to all the contracts which did not contain explicit *Mobile-Sierra* language.[148] On January 17, 2003, the ALJ certified the record to the Commission. On January 24, 2003, the Secretary clarified that the parties were directed to submit their reply briefs directly to the Commission no later than January 27, 2003 and that the Commission would accept the initial briefs filed with the ALJ on January 10, 2003. On January 27, 2003, reply briefs were filed by Complainants, Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley, Sempra, Respondents jointly, Trial Staff and Universal.

Briefs on exceptions to the Partial Initial Decision were filed by the CPUC and the CEOB. Briefs opposing exceptions were filed jointly by Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley and Sempra and by Trial Staff.

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[147] January 10 Order, 102 FERC ¶ 61,025.

[148] *Partial Initial Decision*, 102 FERC ¶ 63,013.

On February 24, 2003, Complainants filed a motion to lodge a complaint which they filed in the Superior Court of California.

On March 3, 2003, Complainants sought to supplement the record in this proceeding with the market manipulation/abuse evidence submitted in Docket No. EL00-95, *et al.* On March 11, 2003, Respondents jointly filed a motion to strike this submission or, in the alternative, a motion for leave to respond to the supplemental submission.[149] Respondents also individually opposed and filed evidence, including new testimony, in response to Com-

[150] On March 20, 2003, Complainants filed reply comments. On March 25, 2003, Complainants filed an answer in response to the motion to

plemental submission. On March 26, 2003, Complainants filed a motion to strike submissions filed by Mirant and Sempra. On April 2, 2003, Allegheny, Coral, Dynegy, El Paso, Mirant and Sempra filed a motion to strike or, in the alternative, a motion for leave to respond to
reply comments. On April 9, 2003, Mirant and Sempra filed a response to Complainants' motion to strike their submissions. On April 10, 2003, Complainants filed a response to the motion to strike their reply comments.

On April 16, 2003, Complainants filed a Motion for Disclosure of Alleged Off-The-Record Communications and Request for Oral Argument. On April 18, 2003, Respondents filed a Motion for Leave to File an Answer and

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[149] On March 18, 2003, Reliant Energy Services, Inc. and Reliant Energy Power Generation, Inc. (collectively, Reliant), an intervenor in this proceeding, responded to Complainants' supplemental submission.

[150] Complainants and Respondents also submitted indexes that had been requested to be filed in Docket Nos. EL00-95, *et al.*, pursuant to a Commission order. *See* February 10 Order, 102 FERC ¶ 61,164.

Answer to the Request for Oral Argument. On April 18, 2003, a notice was issued scheduling oral argument for May 15, 2003. On April 22, 2003, the Commission filed a summary of the events relating to the alleged off-the-record communications, and, on April 23, 2003, the Commission issued an order finding that these were not inappropriate communications;[151] therefore, Complain
closure is now moot.

On April 22, 2003, Complainants filed a Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse. Coral and Sellers filed answers in opposition to this motion.

On May 15, 2003, the Commission held oral argument in this proceeding (Oral Argument).

On June 11, 2003, in Docket Nos. EL02-60-000 and EL02-62-000, Complainants, Allegheny and Allegheny Trading Finance Company (collectively, the Settling Parties) filed a settlement agreement (Allegheny Settlement Agreement).[152] On June 13, 2003, a notice was issued shortening the comment period on the Allegheny Settlement Agreement.[153]

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[151] *Nevada Power Company, et al., v. Enron Power Marketing, Inc., et al.*, 103 FERC ¶ 61,080 (2003).

[152] On that same date, in Docket No. ER01-1847-001, Complainants and Allegheny filed an Amended and Restated Agreement.

[153] The comment period on the Amended and Restated Agreement was shortened also.

Appendix C

Remaining Substantive Issues

1. *Impact of the Spot Market on the Forward Market*

a. *Initial Briefs*

i. *Complainants*

Complainants allege that the prices CDWR agreed to pay in the first five months of 2001 for electricity to be delivered in the remainder of 2001, all of 2002, and into 2003 were enhanced by the expectation that the price-inflating effects of the flaws in the spot markets would not fully attenuate until 2004. Complainants assert that prices were high in the spot market because supply was tight relative to demand and that tightness of supply, in the absence of firm regulatory safeguards, created conditions in which the withholding of even small amounts of supply would substantially raise prices. They contend that tight supply in the electricity markets is the condition that activates and can be exacerbated by market flaws.

Complainants state that forward prices are based upon expected future spot prices, and forward markets are necessarily affected by expected dysfunction in the spot market. They argue that the forward prices that prevailed prior to June 2001 for delivery of electricity prior to 2004 reflected a premium above the price that would have been expected based upon the interaction of supply and demand in a functioning and competitive market as a result of the expected continued effects of spot market dysfunction. They contend that the risk premium analysis provided does not explain the gap between the fundamentals forecast and the actual forward prices. They claim that their expert confirmed that the gap can only be explained by the market's expectation of continued dysfunction in the spot market.

They assert that changes in NOx regulations cannot explain the drop in forward prices. They state that new generation would not have an effect on forward prices. They argue that expectations of economic performance remained the same during the relevant two week period or that there was no unexpected news about nuclear or hydro conditions announced in late May that would have affected forward prices. They claim that the exercise of market power and changes in regulatory appr

contracting also affected forward prices.

Complainants contend that the credit concerns with the IOUs that caused QFs to go offline were a dysfunction, not

negotiations.

Complainants claim that the structure and pricing of the long-term contracts reflect the impact of the dysfunctional spot market. They contend that over time the back-end loaded contracts will provide total revenues that match or exceed the expected spot prices, including the high 2001 and 2002 expected prices, over the life of the contract. They assert that sellers also spread out high prices for 2001 and 2002 by increasing the number of megawatt hours delivered in the back-end years. They state that contract negotiations were driven by crisis conditions that were a direct result of the dysfunctional spot market. They argue that the forward price curves established the floor for the negotiation of the instant contracts, and the contracts are overall priced higher than the expected spot prices would otherwise suggest.

ii. *Trial Staff*

long-term, bilateral energy markets may be attributable to three factors: (1) flaws in the spot markets; (2) competitive market fundamentals; or (3) the exercise of market power or market manipulation. Trial Staff notes that the Commission placed the third outside the scope of the hearing due to the investigation in Docket No

witness testified that: (1) the Commission issued orders addressing most of the flaws it identified in the California spot markets prior to the execution of the contracts at bar; (2) market fundamentals do not improperly affect forward contract prices, but rather produce price signals that such contracts should reflect; and (3) the Complainants failed to meet their burden because they did not distinguish adequately between the adverse effects of any flaws that may have remained in the spot markets and the effects of market fundamentals on the long-term, bilateral markets.

Trial Staff argues that Complainants did not show that expected future prices in the dysfunctional ISO and PX spot markets adversely affected the prices of the forward contracts entered into by CDWR, as the Commission required. Trial Staff asserts that the parties executed the contracts at issue between February 13, 2001 and May 24, 2001, after the PX spot market suspended operation at the end of January 2001. Trial Staff contends that Complainants' witness recognized that PX spot market prices played no role in determining the forward price curves upon which the long-term contracts were based. Trial Staff concludes, therefore, that market participants could have no expectations of future PX spot market prices in determining the prices of the long-term contracts signed between February and May 2001.

Trial Staff claims that Complainants did not produce any evidence explicitly linking the ISO spots markets with the contested contracts, only providing testimony about spot market prices in general.

Trial Staff asserts that the Commission took actions to correct most of the flaws in the California spot markets that gave rise to dysfunctions prior to the execution of the contested contracts, thus eliminating any effects of the flaws on these forward contracts. Therefore, Trial Staff concludes that, even if Complainants had offered evidence on the specific effects of the ISO and PX spot markets on the contracts at issue, as required by the hearing order, they would not have been able to demonstrate any substantial adverse effect from spot market dysfunctions because the Commission took preemptive action to eliminate the dysfunctions prior to the time the instant contracts were executed. Trial Staff argues that, once the Commission acted, market participants were (or should have been) aware that this critical dysfunction that created over reliance on spot markets would be less of a factor affecting prices.

Trial Staff contends that the remaining reasons for prices to continue to be relatively high are: (1) competitive market forces (i.e., market fundamentals); (2) inadequate retail demand responsiveness; (3) possibly the exercise of market power; and (4) market participants may have expected the spot market flaws identified by the Commission to continue, despite Commission action to remedy them, thus affecting their calculation of forward prices. Trial Staff asserts that forward contracts are supposed to reflect competitive market forces on prices (i.e., prices are expected to and must rise to induce the investment in new capacity that is needed to serve customers adequately). Trial Staff claims that, after December 15, 2000, prices in the spot market were becoming less and less reflective of a dysfunctional market design and thus more reflective of competitive market conditions. Therefore, Trial Staff concludes that Complainants must identify and segregate the portion of the forward contract rates at issue which was due to the effect of competitive factors and the portion which was due to other effects. Trial Staff contends that if these distinctions are not made Complainants risk overestimating the effect of any residual spot market flaws or exercise of market power on the long-term contracts.

Trial Staff argues that the position of witness that the high contract prices must either be explained totally by a market fundamentals "hypothesis" or a

asserts that the simple correlation between spot and forward prices and a synchronous decline does not prove or even suggest that high spot prices caused forward prices to be high.

Trial Staff asserts that to demonstrate the magnitude of the dysfunction on the contracts at issue Complainants

eously estimated "the level of overcharge[s]" in the con-

with the costs of an alternative Staff notes that, after acknowledging that he made computational errors, the expert which provided this testimony filed supplemental testimony which conceded that, when corrected, his analysis would

Trial Staff concludes that a review of Complainants' evidence shows that they failed to meet their heavy burden to demonstrate that dysfunctional California spot markets adversely affected the long-term bilateral markets, and, even if they had, they failed to show the extent of any such effect that would warrant the modification of the instant contracts.

iii. *Sellers*

Sellers[154] argue that Complainants have failed to show that the dysfunctional spot markets adversely affected the

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[154] On January 10, 2003, Dynegy, El Paso, Morgan Stanley and Sempra filed a joint initial hearing brief which was virtually identical, [except]

Sellers challenge Complainan

included any market flaw combined with scarcity and a rela

this definition of dysfunction contradicts Commission precedent and well-established economic principles as noted

mony. Sellers also argue that

magnifier" was unsupported by any empirical analysis actually proving that dysfunctions in ISO spot market affected forward markets.

Sellers contend that Complainants ignored the price

sulting (Navigant) developed while the challenged contracts were being negotiated and executed. Sellers note that a version of these price forecasts, one which never contained any "dysfunction premium," substantially exceeded the market-based forward price curves for electricity that were publicly available at the time for all periods other than summer 2001 and that even the difference for the summer 2001 period was small in all but one month.

Sellers also claim that, although the expert admitted that forward natural gas prices, emission allowance costs and other market fundamentals are critical to understanding forward electric prices, he never comprehensively analyzed these market fundamentals in preparing his pre-filed testimony and, thus, had little or no basis for opining that anything other than fundamentals drove forward electric prices.

Sellers also assert that, even if Complainants had shown that dysfunctional ISO spot markets had some adverse effect on the long-term bilateral markets, they did not show that the effect was of sufficient magnitude to warrant modification of the instant contracts.

Sellers argue that their witness demonstrated that the primary drivers of forward prices were market fundamentals, not dysfunctions in the ISO spot markets. Sellers also argue that forward contracts were not symptomatic of dysfunctions in the ISO spot markets, rather they helped cure any dysfunctions that existed in those markets.

iv. *Dynegy*

Dynegy asserts that Complainants did not offer direct analysis of underlying market fundamentals to support their assertions that dysfunction in the forward markets

that evaluated the contract price and did not address

ciated with the fixed and system contingent capacity and energy were not controversial or objected to during the contract negotiations.

v. *Mirant*

Mirant contends that the expert testimony presented by Complainants crumbles when applied to the Mirant Agreement and, in fact, supports a finding that the assumed dysfunctional California ISO spot markets has no adverse effect on the forward markets at the time the Mirant Agreement was negotiated and executed.

vi. *Sempra*

Sempra argues that it does not consider current spot prices in pricing electricity products and that alleged dysfunctions in the ISO spot markets did not influence Sem-

obtained from brokers and traders for electricity and

to CDWR. Sempra also took into consideration: (1) construction and operational costs associated with developing its generation assets; (2) statements by California representatives suggesting that CDWR was looking for prices in the $50-$60 per megawatt-hour price range; (3) losses that Sempra would incur by making sales at below-market rates for the summer of 2001; and (4) the unique credit risks entailed in entering into a transaction with CDWR without credit assurances typically required by Sempra.

Sempra argues that Complainants have conceded that they cannot show that the dysfunctional ISO spot markets had any discernible effect on long-term bilateral contract prices for delivery beyond some unspecified point "into even setting aside Complain- estimates of his dysfunction premium for 2001 through 2003, the magnitude of his dysfunction premium as applied to the Sempra Agreement falls short of that which would be required for Complainants to meet their heavy burden in this regard. It claims of 2.8 to 3.6 percent above a purported ideal rate cannot justify the extraordinary remedy of contract modification under any standard of review.

vii. *Universal*

Universal argues that there are two conditions that must be met for market-based rates to be just and reasonable: (1) there must be a competitive market and (2) the resulting prices must fall within the same zone of reasonableness as cost-based rates. It argues that the long-term bilateral market was not competitive because it was dysfunctional due to the market structure and the pattern of prices is in a range which indicated that market forces were

level. It contends that the dysfunction in the spot market did affect the long-term markets.

Universal challenges the evidence tendered by Trial Staff because it claims that: (1) its witness admitted that he did not perform any study to determine why prices were so high in the California market in 2001; (2) its witness admitted that the long-term market might have been affected by the dysfunction in the spot market, but he decided not to investigate the subject; (3) its witness admitted that he considered only a few and selective portions of the evidence offered by Complainants and Sellers; and (4) its witness did not examine the evidence on the California market that was accumulated by Commission Staff and made available not only to the Commission but also to other agencies such as the U.S. Securities and Exchange Commission, U.S. Department of Justice and Federal Trade Commission. It criticizes other testimony which relied on this witness.

b. *Reply Briefs*

i. *Complainants*

Complainants charge that the lack of installed plants in California was a direct result of market flaws. They contend that these market flaws were also evidenced by a lack of incentives for new construction, changes which would affect the forward markets. They state that the combination of existing market flaws and tight supply led to sellers exercising market power through withholding supply and driving up prices. Complainants argue that the fact that they were precluded from investigating or offering evidence

Complainants allege that

and December 2000 orders did nothing to relieve prices, but rather, caused the spot and forward markets prices to rise. They assert that the result was contracts priced at or above the forward curves, suggesting that there was an expectation of continued dysfunction driving forward prices until 2004.

Complainants assert that Respondents mischaracterize

that the proxy price model does not, as Respondents state, represent a forecast of competitive prices. They claim that

mentals nor an estimate of future competitive prices, but rather a conservative proxy with which CDWR could estimate revenue requirements for electricity purchases.

ii. *Trial Staff*

Trial Staff argues that Complainants have revealed the weakness of their case by switching their primary reliance from their own witnesses' flawed analyses to a graph created by a witness for Dynegy to support their claim that a
isted in 2001 in the forward
markets. Trial Staff explains that the graph displays a gap between the average forwar
forecasts for 2001 and 2002 and that Complainants contend that the gap between the two curves on the graph, which Complainants modified and included in their Initial Brief, shows that forward prices we
dysfunctions. Trial Staff states that the graph, modified or unmodified, shows no such thing. Trial Staff argues that, simply recognizing that a gap exists between a curve depicting forward on-peak prices at a particular California delivery point and a curve depicting prices forecasted by a commercial software model, does not conclusively establish

markets.

Trial Staff asserts that Comp
and forward prices for a particular two-week period in 2001 failed to produce any proof that spot market dysfunction actually affected the forward market. It notes that Complainants assert that their witness independently confirmed that the gap displayed in Exhibit DYN-31 can only be explained by expectations of continued dysfunction in the spot market. Trial Staff argues that the problem with this approach is that it does not demonstrate that the dys-

functional ISO and PX spot markets affected the forward markets and, at best, merely shows that spot and forward prices moved together during those two weeks. Trial Staff also argues that Complainants do not demonstrate the extent to which these price levels were the result of competitive market forces and the extent to which they were the result of other causes, such as market flaws.

Trial Staff argues that the fact that some QFs did not sell generation to California utilities because of credit concerns fails to establish a causal relationship between spot market dysfunction and the forward contracts at issue. Trial Staff states that, by characterizing the credit concerns as a dysfunction, Complainants contend such withholding of power by QFs pushed forward prices up, thus proving their market dysfunction affected forward prices. Trial Staff a ment makes little sense because QFs did not sell their output into the ISO and PX spot markets; instead, pursuant to Section 210 of the Public Utility Regulatory Policies Act, they sold power directly to electric utilities. Thus, Trial Staff concludes that QFs did not have a direct relationship to the spot markets. Trial Staff points out that, as explained in the testimony submitted on behalf of Respondents Morgan Stanley, Sempra, Mirant and Allegheny, beginning in December 2000, the Commission relaxed its restrictions on QFs, allowing them to sell excess output through bilateral contracts.

Trial Staff claims that Complainants were unable to prove their assertion that the pricing structure of the forward contracts, some of which contain levelized prices, was driven by the dysfunctional spot markets operated by the ISO and PX. Trial Staff asserts that the fact that the contracts at issue may have been priced at or above the forward price curves does contention that the prices in the contracts incorporated the dysfunctions in the spot market and therefore must be modified to achieve just and reasonable rates.

Trial Staff states that now Complainants contend that a measure of the excessive burden on ratepayers can be found in Appendix C to their Initial Brief, which they admit um." Trial Staff argues that, not only is it too late for Complainants to attempt to quantify (for the first time) this theory upon which they rely is flawed because there has been no showing that the forward price curves where the product of the dysfunctional spot market.

iii. *Sellers*

Sellers argue that Complainants did not and cannot demonstrate that the dysfunctional spot markets had an adverse effect on the long-term bilateral markets in California. Sellers contend that Complainants point is flawed because it is based upon misguided assumptions and incorrect price comparisons, including a misuse of nesses. Sellers assert that Complainants constructed a faulty analysis of expected prices for 2002 (as of March 1, 2001) and then worked backwards to fill this evidentiary void by purporting to derive a dysfunction premium for 2001 forward prices. Sellers dismiss as mere theory Com- forward prices during a two-week period in late May and early June 2001 demonstrated the existence of a dysfunction premium in the forward market prices. Sellers claim garding this two-week period fails to take into account critical changes in market fundamentals.

Sellers maintain that the evidence shows that the dysfunctional spot markets did not adversely affect the long-term contracts at issue in any material manner. Sellers assert that, contrary to Comp
alone is not a market dysfunction that affected the long-

Commission orders make clear that scarcity contributed to dysfunction in the ISO and PX spot markets only to the extent that it was combined with State-imposed restrictions on the IOUs that forced them to buy power exclusively in the PX spot markets. Sellers state that the Commission eliminated these State-imposed restrictions in January 2001, thereby eliminating this contributing factor to dysfunction in the residual ISO spot markets. Moreover, Sellers argue that even if market participants could exercise market power in the ISO spot markets during conditions of scarcity, it is virtually impossible to leverage such market power into the bilateral forward markets. Sellers state that doing so is especially difficult in the long-term bilateral markets because the market for forward contracts is not the final market available to either a buyer or seller (meaning that the buyer or seller can wait to buy or sell later in the forward or spot markets).

Sellers contend that Complainants failed to prove, under any relevant standard, that the effect of the dysfunctional ISO spot markets on long-term bilateral markets in California was of a magnitude warranting abrogation or modification of the challenged contracts. Sellers argue that Complainants have taken the position that they are entitled to relief if they show that the dysfunctional ISO spot markets had *any* effect on the contracts at issue and that such a position constitutes a collateral attack on the April 25 Order in this case, which requires Complainants to show an adverse effect of sufficient magnitude to warrant abrogation or modification. Sellers claim that, instead of making the required showing, Complainants rely upon a flawed benchmark analysis and unsupported dysfunction premiums. In any case, Sellers assert that the contract costs are below the ten-year $70/MWh target sought and achieved by yments under the contracts did not exceed the level that the retail market was accustomed to paying.

iv. *Allegheny*

Allegheny claims that Compla on that the Allegheny Agreement was priced above its forward curves is patently wrong. Allegheny states that CDWR obtained a just and reasonable price from Allegheny and agreed to compensate Allegheny for the substantial risks it assumed under the contract. Allegheny argues that, contrary to Complainants' misrepresentation, at the time of the

priced at virtually the same level as its forward price curves and carried a *de minimis* $10 million dollar projected of the long-term fixed price contract. Allegheny argues that Complainants fail to mention that, based upon Navi curves at the time of contracting and the swap-price methodology used by Mr. Koenig, the price of the Allegheny Agreement would have been $70/MWh. It concludes that, based upon the Allegheny Agreement price of $61/MWh was substantially cheaper and priced far below expected spot

Allegheny asserts that whether or not the contract was priced at or above the forward price curves at the time of t take into account the fact that Allegheny, like CDWR, was a price taker in the volatile electricity markets and therefore was taking on substantial risks for which compensation was appropriate.

ate that their forward price curves formed the floor for negotiations, analyzed only contracts entered on or before March 1, 2001 and therefore his study did not include the Allegheny Agreement which was signed on March 23, 2001 and April 20, 2001, respectively.

Allegheny states that the record shows the absurdity of Complainants contention that the Commission should "pre-

eement, on the day it was signed, was hugely profitable. First, it states that the record demonstrates that the Allegheny Agreement was not

mark-to-market value, based upon the forward curves from which the price was derived, was a mere $10 million. Second, it points out that Mr. Koenig testified that Allegheny undertook numerous actions to perform under the CDWR contract which resulted in realized cash losses in the hundreds of millions of dollars.

Allegheny alleges that Complainants have not demonstrated that the harm, if any, to California from these contracts is of a magnitude warranting modification. Allegheny argues that Complainants' analysis of contract overcharges, as well as their conclusion that these overcharges harmed the State economy, are so flawed as to invalidate their conclusions. Allegheny claims the corrected analysis of Com-

duce savings to the State of $67.4 million or $92.5 million per year.

Allegheny asks the Commission

arguments that the contracts should be reformed based on

ormance costs because they are not the appropriate measure of the just and reasonable rates of the Allegheny Agreemen costs are not a relevant test for market-based rate authority or market-based transactions.

v. *Dynegy*

Dynegy argues that Complainants has not submitted

ket dysfunction. Dynegy submits that although the State argues that Dynegy's prices were developed based on forward price curves that were affected by spot market dysfunction, it has not submitted
prices and in fact declined to do so. Dynegy contends that allowing Complainants to now argue that they have a new approach to quantifying a dysfunction premium in Dynegy's

ct in that prices under the Dynegy contract are 10 to 25 percent less than the forward price curves at the time the contract was signed. Dynegy points out that under the contract Complainants have the benefit of falling gas prices and that this reduction in gas prices through October 2002 caused lower contract prices. To support its position, Dynegy states that its witness con-

mentals and exhibited no material influence of spot market dysfunction.

Dynegy also alleges that Complainants misconstrue several facts to cast Dynegy in a bad light. Among the facts misconstrued is the amount of capacity CDWR must buy under the Dynegy Agreement. Dynegy claims CDWR is only obligated to take 200[illegible]500 MWs and is not obligated for anything above that. Dynegy
sertion that the tolling requirements of the Dynegy Agree-

prices have fallen providing the State with significant benefits. Dynegy also disputes the accuracy of Complainants' price and attributing 2001 dysfunctionality premiums calculations to that witness. Dynegy alleges that Complainants fail to address forward price curves developed by its own consultant. Dynegy argues that the price forecasts were higher than the market-based forward price curves that existed at the time Dynegy negotiated its contract with CDWR.

Dynegy asserts that Complainants grossly overstate

did not file any testimony, thus depriving Dynegy of an opportunity to engage in cross-examination or file rebuttal

$635-$812 million in profits do not take into account taxes or other offsets, which would result in $387-$495 (accounting for taxes only). According to Dynegy, this amount is below its investment in its California units. Despite this result,

earn profits when the market is tight, enabling them to ride out the lean periods when

vi. *El Paso*

El Paso argues that Complainants failed to show any evidence that supports their contention that El Paso's prices were above market. El Paso states that its evidence proves that contract prices with CDWR reflect market prices with no indication of market dysfunction.

El Paso contends that the fact that agreed upon price was below current spot market prices and near-term forward prices but above long-term prices predicted at the time does not indicate that El

tations of continued dysfunction, as suggested by Complainants. El Paso argues that what Complainants describe as market dysfunction is nothing more than evidence of arbitrage in a competitive market.

According to El Paso there is no evidence in the record that supports Compla El Paso's forward curves were above market. Rather than prove the point, El Paso charges that Complainants improperly assume that a dysfunctionality premium is imbedded in market and contract prices.

vii. *Morgan Stanley*

Morgan Stanley argues that Complainants have failed to meet their heavy burden to demonstrate generally that the bilateral forward contracts between the sellers and the CDWR were adversely affected by dysfunctions in the California spot markets. Specifically, Morgan Stanley states that Complainants have not and can not demonstrate that the Morgan Stanley Agreement contains a dysfunction premium. Morgan Stanley points out that the record fails to demonstrate that dysfunctions in the California spot markets, when exacerbated by conditions of true supply scarcity, necessarily created conditions conducive to the withholding of power that pumped up the prices in the California spot markets. They state that such an assumption

specifically addressed the dysfunctions it believed were affecting the California organized spot markets (*e.g.*, the buy-sell requirement). Morgan Stanley avers that, regardless of whether power was withheld from California, Complainants have failed to demonstrate, and their expert witnesses did not provide any analysis of, a nexus between the California spot markets and the bilateral power markets in the West.

Morgan Stanley notes that its expert witnesses did analyze the relationship between these markets and testified that the pattern of prices in the bilateral spot markets at NP 15 and SP 15 was significantly different than the pattern of prices in the California spot markets. They also testified that the dysfunctions that the Commission identified in its December 15, 2000 Order as extant in the California spot markets were not present in the bilateral spot markets. Further, Morgan Stanley argue that the do cite, the two-week price collapse theory and the GE MAPS model results disprove, rather than prove the existence of a dysfunction premium. Morgan Stanley argues the two-week price collapse theory demonstrates that: (1) changes in market fundamentals do account for the decline in the forward power price during the period between May 24, 2001 and June 6, 2001; and (2) the PJM market either was adversely affected by the same dysfunctions extant in the California spot markets or the PJM market suffered from the same type of dysfunctions. Morgan Stanley claims that Complainants confused, misconstrued, and misused GE MAPS model results so that they would support their theory of the case. However, it notes that when viewed appropriately the GE MAPS model results serve as an extremely conservative estimate of the absolute floor for what prices would have been.

Morgan Stanley states that the factual and empirical record evidence that Morgan Stanley and the other Respondents presented in this proceeding demonstrates that market fundamentals affecting supply and demand were the primary driver of forward prices rather than dysfunctions in the California organized spot markets and that on this basis alone the Commission should find that the Morgan Stanley contract meets the

Morgan Stanley contends
tion of the evidence against Morgan Stanley in Appendix A6 demonstrates that the Morgan Stanley Agreement price was consistent with the forward market price when the contract was executed. Morgan Stanley states that the entire point of Comp

in the Morgan Stanley forward curve. It argues, however, that the "dysfunctionality prem
evidence. Morgan Stanley asse
gation that Morgan Stanley received a $60 million dysfunctionality premium completely ignores the record evidence. For example, Morgan Stanley points to the Morgan Stanley Trader who derived Morgan Stanley's forward curve and priced the contract and testified that Morgan Stanley did not include any premium for the alleged dysfunctional market. Morgan Stanley notes that it also offered evidence that it had no generation capacity to serve the contract and purchased power in the same markets as CDWR, and, as a result, Morgan Stanley was subject to the same prices and price risk as CDWR. Thus, Morgan Stanley concludes that Appendix A6 shows only that Morgan Stanley seeks to operate its business in a profitable manner and does so by offering power at market prices, neither of which is contrary to the public interest.

Morgan Stanley also argues that Complainants attempt
contract along with other
h unsupported assumptions,
general conjecture and improperly attempting to shift the burden of proof onto Morgan Stanley. Morgan Stanley states that Complainants attempt to shift the burden of proof onto Respondents on two central issues: (1) Complainants "ask the Commission to *presume* that each contract, on the date it was signed, were [sic] hugely profitable . . . far exceeding any legitimate costs;" and (2) Com-
have not explained, nor can they, why a purchaser with superior leverage would (1) pay more, not le
price curves, (2) enter into contracts for 10 years, when it really wanted 1-3 year deals, and (3) agree to purchase large amounts of energy in the out years of the contract

with relatively small amounts delivered in the early years

viii. *Mirant*

Mirant argues that Complainants did not demonstrate that the Mirant Agreement

internal forward curve. Mirant states that, although Com-

mention some explicit caveats noted by the witness in presenting his calculations. First, Mirant notes that the witness explained that his calculation of a levelized price was based upon Mirant's historical forward curves for

CDWR (or any other) sale would have been developed using the ask price curve, which is by definition higher than the mid curve. Second, Mirant notes that the witness explained that the forward price curve he used reflected prices for trades of relatively small blocks of power, usually 25 to 50 MW, while Mirant committed to sell CDWR a 500 MW block of power. Mirant argues that the sale of such a large block would tend to command a higher price because as the

that both of these factors tend to depress the forward curve-based price calculation.

Mirant also argues that Complainants failed to mention that forward prices climbed considerably between May 17, 2001, when Mirant and CDWR reached agreement as to basic terms of the Mirant Agreement, and May 22, 2001, when the parties executed the contract. Further, Mirant notes that, according to Compla

May 22 date is the more appropriate date for purposes of comparison since "either party could walk away from a

Mirant states that the only analysis in the record of expected competitive prices as of mid-May 2001 demonstrates that the Mirant Agreement was not adversely affected by spot market dysfunction. It contends that Complainants failed to acknowledge that the GE MAPS modeling analysis relies on market information as of March 1, 2001 only, more than two months before the Mirant Agreement was negotiated.

ix. *Sempra*

Sempra contends that Complainants provided little, if any, record evidence directly addressing the Sempra Agreement. Sempra argues that the State provides no probative evidence demonstrating that the dysfunctional ISO spot markets adversely affected the rates, terms or conditions in the Sempra Agreement. Sempra argues that the State mischaracterized and misused the GE MAPS price forecast model, which did not and cannot model all relevant market fundament in particular, scarcity rents. Sempra contends that, in its initial brief, it demonstrated that this March 1, 2001 price forecast provides no probative evidence concerning the existence or magnitude of a dysfunction premium after March 1, 2001, when the Sempra Agreement was largely negotiated and finally executed. Sempra argues that this analysis was based on information regarding market fundamentals and forward price curves available more than two months prior to the execution of the Sempra Agreement and the expert nor Complainants ever attempted to calculate a dysfunction premium in a similar manner for any period after March 1, 2001. Sempra concludes that it is clear that Complainants failed to demonstrate the existence of a dysfunction premium in forward prices at any point after March 1, 2001, much less on May 4, 2001 (the day on which the Sempra Agreement was executed).

version of this unadjusted fundamental price forecast for on-peak prices prepared by Navigant in May 2001 (the month during which the Sempra Agreement was executed) showed that forecasted prices were significantly above forward prices for October 2001 through the 2005 calendar year, while they were below forward prices only during the summer of 2001. Sempra asserts that compared to the Navigant price forecast, which is more probative of the spring of 2001 than the interpretation of the after-the-fact GE MAPS results, the prices in the Sempra Agreement did not contain a dysfunction premium.

Sempra states that it did not rely on publicly available forward price curves in developing offer prices for the vast majority of its deliveries. Sempra asserts that Sempra considered a variety of factors other than forward price curves for electricity when pricing its bid to CDWR. Sempra also points to statements by California representatives indicating that CDWR was looking for prices in the $50-$60 per MWh range which became the st calculations of its offer prices. Sempra claims that it was hoping to develop a fleet of generation facilities in and around California that would be supported by the Sempra to CDWR. Accordingly, Sempra asserts that its offer price took into account the substantial costs and risks associated with its generation development, while also factoring into its offer price certain costs and risks associated with contractual terms demanded by CDWR. Sempra argues that it only looked to forward price curves for electricity for the first two years of the term of the Sempra Agreement (during which time only 3 percent of the total power provided to CDWR under the Agreement would be delivered); however, Sempra had to look at forward price curves for power for these first two years because Sempra was aware that it would be acting as a purchaser during that time. Sempra argues that Complainants acknowledge that Sem-

Sempra argues that, even assuming arguendo, that the Commission had found market power to be an issue relevant to this proceeding, the evidence shows that Sempra did not possess market power at the time of the negotiation and execution of the Sempra Agreement. Sempra contends that there is no procedural or substantive basis for applying the presumptions on market power issues that Complainants request. Sempra states that Sempra did not obtain authority from the Commission to make sales at market-based rates until April 10, 2001 and that Sempra did not have any power available for sale in 2001. Thus, Sempra argues that it was not "on the spot market" until CDWR made it clear that summer 2001 sales at below-market rates were a precondition to Sempra obtaining a long-term deal with CDWR and Sempra was forced to go out into the spot market as a purchaser to procure power to resell to CDWR. Sempra states that it could not have played any part in the "meltdown of the spot market" which occurred in 2000 and early 2001. Second, Sempra states that the record also shows that there is simply no reason to presume that Sempra expected market power (or any other factor) to keep spot prices high because Sempra expected that spot prices would fall as a result of market fundamentals by 2002. Finally, Sempra contends that the record evidence demonstrates that there is no basis to presume that the rates under the Sempra Agreement reflect the expected future exercise of market power by Sempra or anyone else

demonstrates that the prices
not exceed long-run competitive prices.

x. *Universal*

Universal argues it has shown that the dysfunctions in the California spot market affected long term pricing and that market forces were not acting as a regulatory constraint. It argues that market-based rates must be in the same "zone of reasonableness" as cost-based rates. Universal argues that almost $600,000,000 a year in overcharges is evidence of unjust and unreasonable rates that should be investigated.

Universal questions what constitutes the "zone of rea-

market-based environment. Universal claims that Sellers did not provide data to show that Sellers' rates fell within a zone of reasonableness. Therefore, Universal avers that failure to provide this data is conclusive that the rates were unjust and unreasonable. Universal also argues that it has shown that prices under Sellers contracts were so scattered

forces were keeping prices within the zone of reasonable-

that the rates in question are unjust and unreasonable and that the Commission must act on this showing or violate the FPA.

2. *Benchmark Analyses*

a. *Initial Briefs*

i. *Complainants*

Complainants allege that
benchmark requires adjustments to be useful in evaluating the contracts. They contend that the prices in the Allegheny, Coral, El Paso and Morgan Stanley contracts significantly exceed the benchmark even when $74/MWh is used as the benchmark for the first five years.

Complainants claim that the fact that the contracts incorporate the expected results of the dysfunctional spot markets is enough to satisfy

and move to the remedy phase of these proceedings. They argue that in the absence of the presumptive protection of workably competitive markets, the only other logical method to determine just and reasonable rates for these contracts, while ensuring that all legitimate costs and a reasonable return are recouped by Sellers, is to resort to the traditional cost-of-service approach. Complainants note that, due to the ALJ's ruling that precluded discovery of

strate the excesses embodied in the rates in question in

costs. They state that notwithstanding the limiting effects of this ruling, they developed two surrogate measures of the overcharges that demonstrate that the magnitude of the adverse effect of the spot market dysfunctions on the instant contracts is substantial. First, they assert that evidence establishes that the price in each of the contracts contain the dysfunctionality premiums embedded in the forward price curves for 2001 and 2002. Second, they re

benchmark provides additional corroboration of the magnitude of the adverse effect embedded in each of the contracts.

ii. *Trial Staff*

benchmark should not be adjusted as Complainants' witness who challenged the accuracy of the benchmark because he did not know precisely what was contained in the benchmark because the Western Power Trading Forum did not provide the actual derivation of the $67.45/MWh rate that was adopted by the Commission and, therefore, could not say with any degree of certainty that the rate did not incorporate a 10 percent rate reduction from pre-restructuring levels, as the Commission stated in its December 15, 2001 order or that the rate did not account for the value of ancillary costs included in pre-restructuring retail rates.

Trial Staff contends that to the extent a contract price fell below $74/MWh it should be considered just and reasonable. Trial Staff notes that the Governor had requested that the CPUC develop a benchmark and that Complain-

sonable to assume that the $70/MWh target sought and

folio was the benchmark. Trial Staff points out that the $70/MWh price target which CDWR achieved for its entire portfolio of long-term contracts was approved for pass-through by the CPUC.

of the costs of ancillary services is overstated and based upon erroneous assumptions. Trial Staff claims that the

e level of the benchmark was influenced by natural gas prices tainted by market abuse is without merit because no evidence was presented that market abuse occurred prior to the restructuring of the electric industry in California and it is unclear how historic embedded costs could be influenced by natural gas prices tainted by market abuse. Trial Staff points out that, under the

nchmark reflects the historic costs of a portfolio of assets and therefore can only be meaningfully compared to a whole portfolio of contracts that serve an entire load prof

term contracts which is below the $74/MWh benchmark would be found just and reasonable. Trial Staff claims that, in arguing that the benchmark had to be translated into product-specific benchmarks to be a meaningful standard for comparison with contracts

ness erroneously assumed that the $74/MWh price was not

comparable to the price for a 24-by-7 contract that offers power at a flat level throughout the day and year. Trial Staff also asserts that, in deriving their product specific
ess also erroneously used a cost ratio based on 1997 embedded costs, notwithstanding the fact that the $74/MWh benchmark was based upon 1996 costs. Trial Staff concludes that based upon these errone-
witness concluded that the prices in the Allegheny, Coral, El Paso, Morgan Stanley were above what they would have been if it had not been for the dysfunctional spot market.

Trial Staff does not believe that it is necessary to make any adjustment to the $74/MWh benchmark for the difference in the duration of the contracts and contract prices below the benchmark should be deemed just and reasonable. Trial Staff argues that the three methods of adjustment proposed by Complainants' witnesses are flawed and should not be used. Trial Staff asserts that the Sempra contract is below the benchmark because it provides an average rate below $70/MWh, with power provided during the summer of 2001 at below-market rates. Trial Staff states that the other contracts are more difficult to compare because they are above the $74/MWh benchmark and sets forth the difficulties in the comparison for the Dynegy, El Paso and Morgan Stanley contract.

Trial Staff argues that CDWR was unable to demonstrate any significant adverse affects that these contracts would have on either the California economy or the wholesale and/or retail customers. Trial Staff emphasizes that
on that the instant contracts had macroeconomic impact on the California economy because of overcharges associated with the contracts was discredited when the Responde
errors in the analysis and Co

that, after correction, his analysis would not show that the contracts were priced above long-run competitive prices.

iii. *Sellers*

Sellers argue that Complainants have failed to show any viable quantification of the magnitude of the alleged impact of the dysfunctional ISO spot markets on the contracts at issue. Sellers note that Complainants only attempt to quantify this alleged impact was through the direct testimony of an expert which was flawed and when corrected suggested that the contracts were not adversely affected by the dysfunction because they did not exceed long-run competitive prices derived from estimates of long-run marginal costs. Sellers also argue that Complainan
adjustment version of the Commission's $74/MWh benchmark ignores the plain meanin
establishing that benchmark and has no credible justification. Finally, Sellers contes

witness.

iv. *Allegheny*

Allegheny points out that its contract price of $61/MWh and $76/MWh (for peaking power) are well below the

clock power. Allegheny states that it relied upon the Com-

notes that its agreement is below numerous other benchmarks as well, including CDWR's target price of $70/MWh for long-term contracts. It contends that because the Allegheny contract was priced at $61/MWh it gave the State the leeway to enter into higher priced contracts while not causing the average price to exceed the $70/MWh target. It states that its Offer of Proof demonstrates that Allegheny's March 23, 2001, 11-year, long-term power contract was comparably priced to post-June 19, 2001 contracts and that its April 2001 short-term peaking power contract for power in 2003 was similarly priced even below post-June 19, 2001 contracts that contained similar terms and conditions.

v. *Coral*

Coral argues that the price of energy in the Coral Agreement when levelized over the life of the contract falls

$74/MWh. Coral contends that in formulating an adjusted

esses ignored most of the distinguishing characteristics of the Coral Agreement: its substantial seasonal shaping, the value to CDWR of 500 hours per year of dispatch control over the Wildflower Units, and the agreement becomes a tolling structure in 2006 through 2011. Coral claims that segmentation of the eleven-year contract term into two periods, a five-year term and a six-year term, in the adjusted formula does not produce a valid economic benchmark. It contends that the composite benchmark is equally illogical and produces a

Coral claims that the prices in the Coral Agreement when levelized over the term of the contract fall below the long-run marginal cost of generation in California as

vi. *Dynegy*

Dynegy states that quantitative evidence demonstrates that the price in the Dynegy Agreement was driven by market fundamentals and did not Exhibit any material influence of spot market dysfunction. Dynegy claims that

Navigant Consulting during the negotiation of the long-term contracts as well as the average forward prices reflected in contemporaneous broker sheets.

ing the analysis of GE Maps by noting that Complainants' witness testified that a $6/MWh capacity charge would fully compensate generators [for] their fixed costs, thus, withdrawing criticism of a capacity adder and advocating a high-

tnesses provide the elements needed to disprove Complainants unfounded reliance on

vii. *Morgan Stanley*

Morgan Stanley contends that the long-run marginal cost of new generation is not relevant to the Morgan Stanley Agreement because, as a power marketer and price taker, Morgan Stanley's marginal cost of supplying power to CDWR is the offer side

electricity price curve when the CDWR transaction was executed, not the long-run marginal cost of new generation. It asserts that the forward price curves produced by Navigant for CDWR are equal to, or higher than, the forward price curves that Morgan Stanley used to price its contract with CDWR.

benchmark does not apply to the Morgan Stanley Agreement because: (1) CDWR did not consider the benchmark when pricing the contract; (2) Morgan Stanley relied on forward market prices, not the benchmark, to determine a reasonable contract price; (3) the Commission did not intend for the benchmark to apply to a single contract; and (4) the Commission did not intend to establish a cost-based standard for market-based prices for long-term contracts. It adds that the adjustments to this benchmark appear to

December 15, 2001 Order.

viii. *Sempra*

Sempra argues that Complainants have failed to provide any evidence specifically addressing the Sempra Agreement. It claims that the rates, terms and conditions of its contract are, and were acknowledge by CDWR and California officials to be, just and reasonable. It points out that the rates under the Sempra Agreement are just and reasonable when compared to the benchmarks used by Complainants, including an analysis of long-run competitive

b. *Reply Briefs*

i. *Complainants*

Complainants charge that Respondents have failed to explain the disparity between the forward prices and Dynegy's witness' fundamentals forecast. They state that

the disparity was due to scarcity rent, but rather could be explained by risk premium. They argue that their witness'

capacity adders and Responde
record should be unsuccessful.

tals forecast prices are false due to misleading ranges and use of a weighted average calculation. Complainants con-
adjustments, the 2003 fundamentals forecast is below the forward prices for almost every month. Complainants assert that, despite the inaccuracies of the recalculation by Dynegy, there is still a significant price gap that can only be explained as a dysfunction premium, not a scarcity rent.

Complainants aver that due to the huge disparities between the benchmark contract of $74/MWh and Respondents' prices, which are substantially higher, they have made a compelling showing that a Phase II proceeding is warranted. The benchmark evidence raises a strong presumption that some sellers were exercising market power, thereby raising a similar presumption that the markets were not competitive. Furthermore, Complainants argue that the benchmark was ambiguous and subject to refinement therefore Respondents have no "reliance interest" in their interpretation of the benchmark. Additionally Complainants argue that any contracts exceeding five years should be compared to a benchmark that is extended on the

titive prices. For any years beyond the first five, a benchmark of $74/MWh is not competitive, and should not be considered just and reasonable as Trial Staff argues.

Complainants assert that the benchmark applies to all sellers including power marketers based on underlying policy and prior Commission statements. While Morgan Stanley argues that the Commission did not intend for the benchmark to apply to power marketers, Complainants argue that at no point did the Commission imply that the benchmark only applied to suppliers owning existing generation equipment, nor did it exempt the contracts of power marketers when these issues were set for hearing. Additionally, applying the benchmark to power marketers is consistent with Commission policy objectives to contain prices. If the benchmark did not apply to power marketers in addition to other suppliers, generation owners would instead be insulated from the effects of the benchmark.

ii. *Trial Staff*

Trial Staff argues that Complainants presented flawed arguments concerning the application of the Commission's $74/MWh benchmark to the contested contracts. Trial Staff asserts that, with respect to the contract-specific benchmark analyses presented by Complainants, Trial Staff does not believe that reference to

demonstrates that the rates in these contracts were adversely affected by the spot market dysfunctions. Trial Staff argues that the rates in these contracts merely reflect the

been no showing that those expected future spot market prices were driven by anything other than market fundamentals. Moreover, Trial Staff states that a number of the contracts fully satisfy the Commission's benchmark. For example, Trial Staff points to
an 11-year contract priced at $61/MWh providing both around-the-clock (7-by-24) and peaking power, that is well below the $74/MWh benchmark and should on that basis alone be deemed just and reasonable.

Trial Staff contest Complain on that, notwithstanding the fact that no benchmark analysis was done

conclude that the prices in these contracts also exceed the

be rejected not only because it is completely unsupported and speculative but also because it erroneously places the ultimate burden of persuasion on the Respondents, contrary to law.

iii. *Allegheny*

Allegheny contests Complainants' contention that the

in perspective just how extraordinary these agreements
there is no basis for the Commission to adopt this one-size-fits-all approach to characterizing the contracts at issue in this proceeding because the Allegheny Agreement and circumstances in which it was negotiated were distinct from the Dynegy Agreement. For example, it notes that the Dynegy Agreement involves sales from a group of generating facilities that Dynegy purchased while Allegheny owns no plants. It points out that Complainants allege that they entered into the Dynegy

Dynegy was offering for the su
Allegheny owned or controlled no generation in the market, its entry into the market did not impact the quantity of supply available to the CDWR. It asserts that CDWR wanted to shift to Allegheny the costs and risks of purchasing at
ney by using Allegheny effectively as a bank. Allegheny states that other differences with the Dynegy Agreement include the fact that: (1) Alle-
th CDWR exceeds ten years, while the Dynegy contract is much shorter with a duration of three years; and (2) unlike Dynegy which structured a portion of its contract as a tolling arrangement with CDWR taking fuel risk, Allegheny assumed the full risk of fluctuating prices of natural gas in its contract.

Allegheny argues that the comparison to the Commission's $74/MWh benchmark shows that the Allegheny Agreement is *per se* just and reasonable, rather than that the Allegheny Agreement was affected by dysfunction. Allegheny challenges Complain

when $74/MWh is used for the first five years. Allegheny asserts that Complainants neglect to mention that the

ethod for the period beyond

thoroughly discredited. Allegheny states that the figures cited by Complainants as the amounts by which the Alle-

meaningless and incorrect and that Complainants claim that these figures evidence effects of the dysfunctional spot market on forward markets is meritless. Further, Allegheny claims that Complainants' contention is surprising since their own pre-filed testimony shows, as confirmed by Dr. Pechman on cross-examination, that the first five years of the Allegheny $61/MWh rate is not only substantially lower

than the lowest version of
adjusted and product-specific adjusted benchmark of $61.50. It notes that Trial Staff agrees that the Allegheny

mark. Thus, Allegheny believes that the comparison of the primary Allegheny Agreement, at $61/MWh, to Complain-
of non-dysfunctional prices shows that the Allegheny Agreements produce significant savings, as

compared to the Commi

iv. *El Paso*

102. El Paso asserts that Complainants cannot adequately compare the El Paso Agreement with the $74/MWh benchmark. It contends that comparing the two ignores the extrinsic factors that justify the terms of the contract. El Paso argues that Complainants ignored the specific guidance of the Commission as to the legal effect of the benchmark: anything below the benchmark is just and reasonable. El Paso also argues that, in *San Diego Gas & Elec.*,[166] the Commission stated that buyers may elect to enter into contracts above the level of the benchmark provided the contract suits their needs. Based on this holding, El Paso avers that there is no justification for using the $74 benchmark. Even if the benchmark was a starting point used to measure the reasonableness of the El Paso Agreement, El Paso argues that it provided values other than price to CDWR, such as bearing additional default risk than is standard in order to assist California during its power crisis. El Paso contends that these additional non-price values should be taken into consideration as well.

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[166] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services*, 93 FERC ¶ 61,294, at p. 61,995 (2000).

v. *Mirant*

affirmative finding that the challenged contracts were adversely affected by dysfunction in the ISO spot markets by comparing four of those
$74/MWh advisory benchmark should be rejected. Mirant

these four contracts exceed the relevant benchmarks are so wide that it is only proper to conclude that the remaining contracts, Dynegy, Mirant and Sempra . . . must also exceed
noting that Complainants
ask the Commission to presume that the Mirant Agreement would not compare favorably
mark, if such an analysis were (or could be) done, and that contract modification is warranted as a result. Mirant notes
witnesses never applied the
benchmark to the Mirant Agreement. Mirant states that
at hearing that the Commission's $74/MWh benchmark was developed as a guideline for contracts with a five-year term and could not readily be applied to the nineteen-month Mirant Agreement. Mirant asserts that the burden is on Complainants to show that the challenged contracts were adversely affected by spot market dysfunction and that, if Complainants believed that a benchmark comparison could establish that link, they should have provided that comparison as part of their affirmative case.

Mirant notes that it undertook its own benchmark analysis as part of its direct case
rt witness compared the Mirant Agreement to three other CDWR power purchase agreements and found that the price in the Mirant Agreement was comparable to the prices in those contracts. Although Mirant's expert's testimony was stricken, Mirant points out that the ALJ allowed Mirant to submit the

stricken testimony as an offer of proof. Mirant argues that, if the Commission agrees with

benchmark comparison should be taken into account, the case against modification of

clearer because the analysis further demonstrates that the Mirant Agreement was not adversely affected in any manner by dysfunctions in the ISO spot markets. Mirant states that regardless of whether the Commission considers

that the Commission should assume that the Mirant Agreement would fail any such benchmark comparison because

proper and is a request for a presumption based upon analyses that were never done.

vi. *Morgan Stanley*

Morgan Stanley states that the difference between the $74/MWh benchmark and the Morgan Stanley contract price does not prove that Morgan Stanley included a dysfunctionality premium in the contract price.

vii. *Sempra*

Sempra states that the Sempra Agreement compare favorably to a variety of benchmarks. Sempra points out that while Complainants' witnesses decided against conducting an analysis of the Sempra Agreement, Sempra sub-

direct case. Sempra states that its witness compared the rates in the Sempra Agreement against 14 long-term contracts that CDWR entered into after June 19, 2001 (when no party alleges that ISO spot markets were dysfunctional) and found the prices in the Sempra Agreement to be comparable, or in a number of instances, superior to prices in these 14 long-term contracts executed after June 19, 2001. As a result, its witness concluded that the Sempra Agreement was free from spot market dysfunctions. Sempra contends that, to the extent the Commission agrees to ac- it provides another piece of evidence showing that the Sempra Agreement should not be subject to abrogation or modification.

3. *Relative Bargaining Power*

a. *Initial Briefs*

i. *Complainants*

Complainants assert that the number of bids received in response to the RFBs is insignificant because all of the negotiations occurred above the inflated forward price

CDWR had options is further undercut because: (1) many of the bids were for less than 100 MWs when CDWR needed 12,000-15,000 MWs; (2) many of the offers started delivery after the summer of 2001; and (3) many of the sellers were unknown entities without experience in the power industry.

Complainants argue that, under the extraordinary circumstances in which CDWR was purchasing power, CDWR had essentially no bargaining power. They assert that Respondents have not explained and cannot explain why a purchaser with superior leverage would: (1) pay more, not price curves; (2) enter into contracts for 10 years when it needed 1-3 year contracts; and (3) agree to purchase large amounts of energy in the out years of the contracts with relatively small amounts delivered in the early years when the purchaser desperately needed the power.

ii. *Trial Staff*

Trial Staff argues that the totality of purchases and the conditions present at the time the contracts were entered into do not justify contract modification. Trial Staff contends that CDWR, through the California Energy Resources Scheduling Division (CERS), procured a diversified portfolio of contracts which varied in terms of the products provided and length of the contract with a variety of suppliers and power companies at an average contract price over the May 2001 through December 2010 period below the $74/MWh benchmark established by the Commission. Trial Staff claims that the terms and conditions of the proposals made by CDWR and the processes and procedures CDWR used to evaluate the contracts were the result of decisions freely made by CDWR. Trial Staff asserts that

intended to, and did, shift considerable risk to the sellers such as the risk of rising natural gas costs and the lack of payment assurances. Trial Staff also contends that CDWR

cost of long-term contract energy expected to be within the combined average cost of energy supply reflected in the

tegy later changed when it

sity of supply sufficient to cover the net short for the summer of 2001 at an average price not to exceed the $70/MWh benchmark established by those in charge of the negotiations with the objective of depriving the spot market of its volume and thus taming its out-of-control prices.

Trial Staff concludes that CDWR mostly succeeded in meeting its objectives: (1) forming a portfolio of short, intermediate and long-term contracts covering a variety of energy products (*e.g.*, 24-by-7 or baseload supply and 6-by-16 peaking service) at an average price that fell below the $70/MWh benchmark it had set; and (2) stabilizing the market by entering into long-term contracts. Trial Staff claims that CDWR did not have a formal process in place for reviewing or evaluating the contracts until mid-March 2001 which led to ill-advised decisions or choices. Trial Staff concludes that CDWR's RFBs and its purchasing strategies were the reason that CDWR may have purchased supply under contracts with longer terms than it would have liked. Trial Staff notes that CDWR issued RFBs in which the entire risk of the rising cost of gas was placed on the sellers, the sellers had no assurance that CDWR would meet its financial obligations and CDWR set its pricing goals significantly below the current market prices.

Trial Staff contends that, given the number of parties who were interested in selling power to the State of California on a long-term basis, CDWR had options and did not lack bargaining power due to the crisis that existed. Trial Staff argues that, in fact, it was the sellers who may have lacked alternatives, given the fact that CDWR was in essence "the sole purchaser" who controlled the information

future supply. In response
these numbers are deceiving because many of the bids were less than 100 MW when CDWR needed 12,000-15,000 MW, many of the offers did not start deliveries until after the summer of 2001 and many of the sellers were unknown entities with no experience in the power industry, Trial Staff states that these arguments assume that the referenced sellers were the only ones with whom CDWR was negotiating while the evidence presented indicates otherwise.

tion that it was not "the
rs profitable alternative of
selling their power in the dysfunctional, high priced spot market and the circumstances under which it was purchasing (*i.e.*, continuing Stage 3 alerts and its inability to continue purchasing in the high priced spot market), Trial Staff notes that CDWR's witness admitted that CDWR was

that was not elastic, CDWR did not expect the high prices in the spot market to last beyond a year or two at most and CDWR and sellers knew that once CDWR began to procure long-term supplies it would have an adverse affect on the lucrative spot market. Trial Staff also notes that CDWR negotiated with sellers on an individual basis and controlled the information sellers had on its negotiations with other

offers would be accepted. Trial Staff notes that, even if CDWR lacked options or believed that it lacked options in these negotiations, sellers did not given that impression due to the situation and the press reports. Trial Staff also notes that, after executing the first few long-term contracts, CDWR gained negotiating leverage and could be more selective regarding prices and terms.

Trial Staff argues that contemporaneous statements made by CDWR and the Governor indicated that they fully supported the price, terms and conditions of these contracts at the time they were executed. Trial Staff notes that the

contracting efforts confirmed his press statement reported

e prices just get ridiculous

that bridge when we get there."

Trial Staff provides a contract by contract review of the Dynegy, El Paso, Morgan Stanley and Sempra agreements to demonstrate that CDWR was not forced to accept unreasonable rates, terms or conditions, but rather achieved its targeted objectives and willingly agreed to enter into these contracts.

iii. *Sellers*

Sellers state that the evidence demonstrates that CDWR established and achieved its long-term contract objectives: (1) CDWR established and achieved the objective of obtaining power at a portfolio average price of $70/MWh;

and (2) CDWR established and achieved non-price objectives.

iv. *Allegheny*

Allegheny argues that it entered into arm's-length negotiations in good faith with CDWR at the solicitation of CDWR. Allegheny states that the terms of the solicitation and the contract were largely dictated by CDWR.

Allegheny notes that, by the time CDWR signed its contract with Allegheny late in the process, long-term agreements had been reached by CDWR with over 30 parties for more than 8,000 MW and CDWR had reached its goal of contracting for fifty percent of
asserts that, by that time, CDWR was negotiating contract terms and conditions that were more beneficial to CDWR than the prior contracts.

Allegheny contends that it had little bargaining power because it sought to enter into a long-term contract in the western markets. Allegheny claims that CDWR made several key demands on Allegheny as a precondition to entering into a contract, including: (1) Allegheny would commence service beginning in March 2001 through the summer 2001 peak periods; (2) Allegheny would back load the contract and sell peak power to the State at a subsidized rate of $61/MWh (when peak prices were approaching $450/MWh); and (3) Allegheny would assume all market exposure to changes in electricity and gas prices. Allegheny states that it agreed to these conditions.

Allegheny asserts that CDWR asked Allegheny to commit to a performance obligation with CDWR, which Allegheny describes as essentially a shell entity without assets, cash or credit, and that CDWR would not provide any guarantees from the State or any other creditworthy entity

Allegheny contends that CDWR had substantial bargaining leverage with Allegheny by virtue of the hundreds of offers in response to it solicitations and thousands of megawatts more offered outside the solicitation process. It asserts that CDWR kept the terms of these offers from Allegheny and that CDWR used this information in negotiations as leverage against Allegheny. Allegheny argues that CDWR had ample bargaining power and numerous options as illustrated by CDWR
unconventional contract terms, including agreeing to sell at a substantial loss in the initial period of the contract, which Allegheny states it had to accept.

Allegheny states that the contract prices were strictly based upon then-prevailing forward curves, not the current spot prices. It contends that it assumed all exposure to changes in market prices which was significant.

Allegheny states that it was required to and in fact hedged its obligations under the contract, including purchasing power at a loss in the high spot markets to honor its contract obligations to CDWR. It adds that it also entered into a long-term tolling arrangement in April 2001 at the height of the market dysfunctionality at a substantial cost to insure its performance for the entire contract term. Allegheny contends that both CDWR and Allegheny knew that Allegheny would be required to sell power to CDWR at a substantial loss in the early years, with the expectation that Allegheny would recoup such losses at the back-end of the contract. Allegheny states it incurred hundreds of millions of dollars in realized cash losses to date in honoring its obligations under the contract.

Allegheny asserts that CDWR set out to accomplish specific goals in procuring long-term power, including reducing its reliance on the spot market and providing a secure and reliable long-term source of supply. Allegheny states that it helped CDWR accomplish these goals.

v. *Coral*

Coral argues that Complainants failed to prosecute two of their three complaints against the Coral Agreement. It notes that Complainants had alleged that three provisions were unjust and unreasonable and thus should be abrogated or modified: (1) Sec. 10.2(b) which subordinates CDWR's bond obligation to the payment to Coral for energy and capacity supplied to CDWR under the contract; (2) Sec. 3.10 which provides Coral with most-favored-nations rights with regard to credit, security and payment priority, and (3) Sec. 3.6 which adopts the March 16, 2001 fixed prices, as modified May 25, 2001, by CDWR for energy deliveries from May 24, 2001 to December 31, 2005.

Coral responds that it was CDWR who proposed both the bond subordination and most-favored-nations provisions, and Complainants did not present any evidence demonstrating that these provisions were unreasonable. It notes that Complainants Coral-specific evidence focused entirely on the third disputed provision regarding price.

vi. *Dynegy*

Dynegy points out that Complainants did not discuss the particular terms of the Dynegy Agreement either in its direct or rebuttal case. Dynegy argues that the Dynegy Agreement was a mutually beneficial agreement sought by both parties. It contends that CDWR had the resources of the State behind it, was advised by consultants, had choices and wielded significant leverage during the negotiations. It states that the length of the Dynegy Agreement was not controversial during the negotiations. It notes that the Dynegy Agreement is not back-end loaded: the pricing provisions for the firm (fixed-price) and contingent (tolling agreement) power do not change over the life of the contract and Complainants benefit from the reduction in natural gas prices. It asserts that Complainants have no basis for complaining about the non-price provisions in the Dynegy Agreement.

vii. *El Paso*

El Paso contends that the El Paso Agreement arose out of an arms' length negotiation that required compromise on the part of each party to reach a mutually agreeable price term. El Paso states that, once CDWR indicated its unwillingness to enter into an agreement using standard industry credit protections, El Paso acquiesced and agreed to include CDWR's proposed terms, including its proposed

acquiesced to additional terms, most of which constitute the clauses that Complainants request be abrogated on the ground that they reflected unequal bargaining positions of the respective parties. It argues that CDWR had a savvy, experienced negotiating team and numerous options. It states that there is no evidence that CDWR was not content with the negotiation or the agreement reached. It contends that, to the extent CDWR operated under any limitations in its bargaining posture and in its choice to contract with a particular party, those limitations were self-imposed. It claims that, if CDWR had not

retail rate objectives and had acted over a longer timetable, California would have been able to take advantage of declining prices. It argues that CDWR and its advisors realized that El Paso had treated CDWR fairly in connection with the two 50 MW purchases because CDWR chose to pursue a follow-on contract with El Paso. It notes that during the negotiations CDWR representatives and the Governor gave assurances to El Paso that CDWR and California would perform their end of the deal.

viii. *Mirant*

Mirant argues that the only evidence in the record on the specific circumstances of the Mirant Agreement shows that Mirant did not exert any undue leverage in entering into this contract.

ix. *Morgan Stanley*

Morgan Stanley argues that CDWR, not Morgan Stanley, had superior bargaining power in their contract negotiations.

x. *Sempra*

Sempra claims that the Sempra Agreement was the result of a lengthy negotiation process in which CDWR enjoyed significant bargaining power over Sempra and Sempra had few options available to it.

b. *Reply Briefs*

i. *Complainants*

Complainants argue that whether or not CDWR exercised or held bargaining leverage is not a factor to be considered in whether the resulting contracts are just and rea-

dermine any bargaining leverage argument as none of the contracts were priced below the forward curves. They assert also that Respondents had other options for power sales and it was their choice to remain in the spot market during a period of unprecedented pricing.

ii. *Trial Staff*

Trial Staff contends that Complainants did not show that the bids CDWR received for power supply reflected continued expectations of dysfunction in the spot markets. Trial Staff notes that, according to Complainants, the fact that CDWR had to accept contract terms that it was not content with supports their claim that CDWR did not have superior leverage in the negotiations. However, Trial Staff argues that Complainants fail to mention that in order for CDWR to meet its purchasing objective of keeping the average price of its portfolio at or below $70/MWh, CDWR was going to have to accept longer term contracts with a levelized price, regardless of the leverage it may or may not have had at the bargaining table. Trial Staff argues that this price target combined with the fixed-price contracts CDWR was seeking had an impact on the type of offers that CDWR was receiving in response to its RFBs. Trial Staff notes that Complainants contend that the offers that CDWR received did not come close to the amount of energy needed to make it through the summer of 2001; in support, Complainants refer to Exhibit CAL-157 which reflects the bids CDWR received in response to the two RFBs. Trial Staff argues that Exhibit CAL-157 does not tell the real story because it does not include the offers CDWR was receiving from suppliers outside of the RFB process – offers that were for significant amounts of energy.

iii. *Allegheny*

Allegheny points out that Complainants have dropped the contention raised in its Complaint that the contracts

abrogating or modifying the contracts. It notes that Com-

s and that, "in some cases, CDWR was able to negotiate on material terms, including

, at hearing, Complainants elected not to put on a fact wi

testimony that many of the key terms in the Allegheny contract, including those relating to price and duration, were driven by the CDWR. Allegheny argues that this was not surprising given the numerous contracts rejected by CDWR on the basis of price, (including rejecting Alleeny. Allegheny states that

price terms, coupled with Mr
mony regarding price negotiations, compels a finding that Sellers did not have bargaining power over CDWR in the forward bilateral markets with respect to both price and non-price terms.

Allegheny states that Complainants misstate the record regarding CDWR's negotiating position with Allegheny and that the CDWR received valuable and significant megawatts from Allegheny in the front end of the contract and could have received more. First, it asserts that the Allegheny $61/MWh Agreement provides for 750 MW of 6x16 peaking power from April 1,2001 to June 30, 2001 and 250 MW of 6x16 peaking energy from July 1,2001 to September 30,2001 at a subsidized, fixed price despite tight supply conditions and the high volatility in the market. Second, Allegheny states that it made numerous offers in

or changed to suit its needs.

Allegheny also argues that Complainants fail to address the evidence demonstrating that CDWR had ample bargaining power and achieved its objective. In response to Complainants' claims that the responses to the RFBs, which separately provided bids for approximately 13,000 and 16,000 MWs, respectively
most about 5,000 MW under contract for the summer of 2001, about one third of the projected peak net short energy demand," Allegheny argues that Complainants provide no evidence that CDWR did not or could not negotiate with the bidders about providing power in the summer of 2001 or earlier. Allegheny avers that CDWR used its considerable leverage to get Allegheny to supply peaking power in the spring and summer of 2001, after Allegheny proposed to

provide power beginning in October 2001. Allegheny argues that Complainants assume that CDWR negotiated only with the sellers that provided further responses to the RFBs, but note that, to the documents demonstrate that CDWR negotiated and contracted with many other sellers outside of the RFB process. Allegheny claims that not once in Complain Brief do they mention that CDWR rejected at least 45 proposed contracts, involving thousands of megawatts, more than half of which were rejected because of the price terms. Allegheny asserts that rejection of these proposed contracts "came in various stag

iv. *Dynegy*

Despite worries about the State's creditworthiness, Dynegy states that it entered into short-term contracts in an effort to assist the State with its energy crisis during ongoing contract negotiations. Dynegy asserts that throughout these negotiations the State threatened to use the

out of deals, and demanded renegotiation.

ing power is misplaced. According to Dynegy, the State uses an inaccurate profit estimate as proof that Dynegy had uneven bargaining power that Dynegy used to compel the State to accept prices that contained spot market dysfunction premiums. Dynegy responds that its contract helped the State meet important goals. Dynegy states that the Dynegy Agreement was for a short-term, the contract prices were under the forward curves at the time the contract was made, and the agreement did not backload capacity, instead making 1000 MW immediately available.

Dynegy concludes that the St

tracts with Sellers do not apply to the Dynegy Agreement.

Dynegy contends that the State knew what it was bargaining for with Dynegy and obtained what it wanted through its negotiations with Dynegy. According to Dynegy, the result was short, medium and long-term contracts with an average price of $70/MWh. Dynegy asserts that the State was content with its bargain but now reaches a different conclusion.

v. *El Paso*

According to El Paso, testimony shows that prices were

vi. *Mirant*

Mirant asserts that Complainants have mischaracterized the facts in an effort to show undue bargaining strength on the part of Mirant. Mirant states that when these distortions are eliminated and the context is understood, it is clear that Mirant did not have superior bargaining strength in its negotiations with CDWR, and, if anything, the evidence shows that CDWR may have had superior leverage given its status as the biggest (and virtually the only) creditworthy purchaser in California. Mirant states that, contrary to Complainants' position that Mirant was seeking to avoid a long-term deal and focus on alleged higher profits in the short-term market, Mirant actually refrained from making a shorter-term deal pending completion of its May negotiations with CDWR.

vii. *Morgan Stanley*

Morgan Stanley asserts that Complainants have not proven, and cannot prove, that Morgan Stanley exercised superior bargaining power in negotiating its contract with CDWR. It contends that the rate, terms and conditions in

between sophisticated market participants and, if anything, the record evidence shows that CDWR, rather than Morgan Stanley, had the superior bargaining power in the contract negotiations.

viii. *Sempra*

Sempra asserts that CDWR had bargaining leverage

for purposes of securing a long-term contract of the magnitude that could be used to support the significant amounts of generation that Sempra wished to develop in and around California, while CDWR had a broad variety of sellers willing to make sales to it and had secured a large percentage of the power it wished to have under contract prior to the execution of the Sempra Agreement. Sempra also states that Trial Staff confirmed that, by the time the Sempra Agreement was executed, CDWR had significant bargaining power over potential suppliers and that as early as February 2001, a CDWR negotiator felt that CDWR had the ability to tell a potential supplier to "take a hike" and

that once CDWR executed the first few long-term contracts, it gained greater negotiating leverage and could be more selective as to what prices and

Sempra contends that it made repeated concessions to CDWR throughout the negotiation process, including modifications to Sempra's initial bids that resulted in Sempra making sales to CDWR during the summer of 2001 at below-market rates, reducing the amounts of baseload energy that Sempra would provide to CDWR and taking on transmission risks that would ordinarily be allocated to the buyer. Sempra states that, although Complainants now claims that CDWR did not want large amounts of power in the

Sempra had offered CDWR the option of having Sempra provide smaller amounts of power, over a shorter period, than the parties eventually agreed to in the executed Sempra Agreement.

Sempra argues that, contrary to Complainants' claim that ISO spot market dysfunctions forced CDWR to enter into contracts with the Sellers, CDWR was under no obligation to enter into any long-term contracts in order to satisfy its obligations under California law, much less the ten plus year Sempra Agreement, and, indeed, CDWR was not legally obligated to purchase power under contracts of any duration. Further, Sempra claims that the record evidence demonstrates that, even to the extent CDWR believed it was compelled to purchase power, its need was only for near-term purchases for the summer of 2001. Moreover, it contends that record evidence demonstrates that CDWR sought to enter into long-term contracts with market participants such as Sempra to encourage the entry of new generation, a goal separate and apart from any need to acquire near-term supplies.

4. *Equities of Modification or Abrogation*

a. *Initial Briefs*

i. *Complainants*

Complainants assert that contract reformation here would not impede the making of contracts in the normal course. They argue that sellers would know that, absent a declared market dysfunction which they would be aware of, their contracts would not be reformed. They state that, even in such circumstances, sellers would know that sellers would recover a healthy rate of return even if reformation were ordered. They contend that, if no remedy is available in these circumstances and another crisis occurs, the public would be loathe to enter into forward contracts for which no remedy would be available. They assert that the public would opt instead to stay in spot markets and seek refunds. They conclude that for these reasons the denial of a remedy here would deter forward buying precisely when it is otherwise desirable.

ii. *Trial Staff*

Trial Staff notes that contract modification may have an adverse impact on the efficient operation of the power market, on investment in new generation and on the willingness of market participants to enter into long-term contracts in the future. Trial Staff points out that any increase in prices associated with the potential regulatory risk of abrogation or modification of contracts will eventually be borne by customers in the form of higher energy costs. Trial Staff argues that the issue of investor confidence is of utmost concern and that contract abrogation or modification should not be permitted, therefore, unless a sufficient showing has been made that such an extraordinary remedy is required given the adverse affect such action could have on investor confidence in the industry.

iii. *Sellers*

Sellers argue that Complainants have not shown that the contracts place an excessive burden on customers. Sellers argue that sound policy demands that the sanctity of these contracts be affirmed. Sellers request that the Commission discourage other states from pursuing Cali-

abrogation or modification of the contracts at issue will discourage forward contracting and defeat the solution that the Commission prescribed for Ca

Sellers point out that, if it grants the complaint, the Commission will discourage needed investment in generation.

iv. *Allegheny*

Allegheny concludes that Complainants failed to meet

trary to the public interest or even that modification would be appropriate under the lo strated that it would be substantially financially harmed if the agreement were abrogated. It argues that the Commission should not modify or abrogate the instant contracts but rather affirm the sanctity of the instant contracts.

v. *Mirant*

Mirant contends that Complainants have failed to provide evidence that would support abrogation or modification of the Mirant Agreement unde

dard. Mirant argues that Complainants have not shown that the challenged contracts impose any burden on customers, did not attempt to argue that the Mirant Agreement is contrary to the public interest based upon a comparison with the Commission's $74/MWh. Mirant asserts that Complainants have not offered any credible evidence to

the specific and immediate detrimental effects of contract abrogation, as demonstrated by the current statements and reports of ratings agencies.

vi. *Morgan Stanley*

Morgan Stanley argues that Complainants did not offer any evidence that the Morgan Stanley Agreement itself will impact CDWR's financial ability to continue service, constitutes an excessive burden on other CDWR wholesale customers, or is unduly discriminatory against other CDWR wholesale customers. It contends that the Morgan

sale power amounts to a mere fraction of the power CDWR contracted for to serve California during the relevant period and could not have any

financial ability to continue service, constitute an excessive burden on wholesale customers or unduly discriminate against wholesale customers.

Morgan Stanley argues that abrogation of the Morgan Stanley Agreement or substitution of the $74/MWh benchmark as requested by Complainants would cause Morgan Stanley significant losses. It states that, if the contract is modified, Morgan Stanley will be less willing to enter into forward wholesale electricity contracts in the future and prices in any such contract would include a risk premium to protect Morgan Stanley and its shareholders from increased regulatory risk. Additionally, it claims that such an action would not be in the public interest because it would

al of a viable competitive wholesale power market.

vii. *Sempra*

Sempra notes that the Sempra Agreement provides incentives for the construction of new generation which will directly benefit California and its customers but places Sempra at risk because the generation is unlikely to be profitable under current spot market and current expected future spot market prices. Sempra states that abrogation of the Sempra Agreement would be disastrous for Sempra in terms of its ability to develop and construct new generation and may result in the company ceasing to exist.

b. *Reply Briefs*

i. *Complainants*

Complainants argue that they have shown that the public will bear unjust and unreasonable rates and that the public interest in competitive markets is threatened by allowing Respondents' exploitation of the spot market dysunction in order to reap windfall profits in the forward markets. Complainants contend that the public should not have to bear the dysfunctional future spot market rates that the Commission has determined they should not bear for spot market purchases from October 2, 2000 through June 20, 2001 merely because the rates are embedded in long-term contract prices. Moreover, the public interest in restoring confidence in the electric industry and avoiding the creation of uneconomic demand-side incentives should outweigh the regulatory risk to the sellers. Complainants further argue that because the sellers' market-based rate authority is regulated by the Commission, sellers were aware of the likelihood that, once the market was no longer competitive, they would have to justify their contract rates.

Complainants state that contracts that are the product of arm's-length negotiation between discriminating buyers and sellers in a competitive marketplace should naturally

assert, however, that such is not the case in the instant matter. Here, high forward contract prices for delivery of power greatly exceeded prices that would result from a normally functioning competitive future spot market. Thus, the public should not be burdened with rates based on expected noncompetitive market conditions. In response to Respondents' challenge that reforming the contracts could cause future buyers and sellers to determine that contracts are not safe from hindsight modification, Complainants answer that argument by suggesting that the Commission explicitly state the reasons for any contract modification that might take place in these circumstances, stating that regulatory risk through modification of power purchase agreements has always been part of the electricity market landscape.

Complainants contend that failing to reform these contracts under these extraordinary circumstances will create disincentives for future buyers to enter into forward contracts because they will lose the possibility of refunds for spot market purchases. They state that, if the contract prices reflect an expectation that the spot market dysfunctions would inflate prices over competitive levels for 2001, 2002 and 2003, then public policy dictates that the Commission alleviate the burden of those prices on the public.

ii. *Sellers*

Sellers argue that the State has wrongly attempted to use its own flawed policies on market restructuring as a reason for relieving the State of its contractual obligations to Sellers. Sellers contend that modifying the CDWR contracts will signal that the Commission will protect states from their own mistakes, such as implementing fundamentally flawed restructuring plans, even to the extent of modifying freely negotiated commercial contracts. In short, Sellers maintain that the State should take responsibility for its own errors, especially regarding retail matters over which the Commission has little, if no, jurisdiction.

iii. *Dynegy*

Dynegy argues that to allow the contract to be rewritten would send a negative message to market participants who might refuse to negotiate the next time markets are tight.

iv. *Sempra*

Sempra also avers that the State fails to justify the abrogation or modification of the Sempra Agreement under either the *Mobile-Sierra* First, it contends that the State fails to provide any direct evidence showing the Sempra Agreement to be unjust and unreasonable and instead attempts to attack the Sempra Agreement based solely on flawed and invalid comparisons. It claims that Complainants do not provide accurate information on the Sempra Agreement because, for example, the price in the Sempra Agreement is linked to a gas index price for the period from June 1, 2003 through September 30, 2011, rather than through September 30, 2003, as Complainants claims. In addition, the price for power provided on a 6 x 16 basis under the Sempra Agreement during the gas index price period is not "$31/MWh + (gas index x 10,500)" as Complainants represents. Thus, it argues that Complainants mistakes a key element of the pricing provisions of the Sempra Agreement: the heat rate for 6 x 16 power.

Sempra states that there is also no value in Complain-

ra Agreement to the Dynegy and Coral Agreements. It notes that the Dynegy contract is a three and a half year contract under which Dynegy will supply power to CDWR from existing generation resources. In contrast, it points out that the Sempra Agreement has a term of more than ten years and is structured with the intent of allowing Sempra to develop and construct new generation sufficient to meet its delivery obligations under the Sempra Agreement. As for the Coral Agreement, it claims that Complainants' witnesses admitted that the Coral Agreement and the Sempra Agreement were dissimilar, and, in rebuttal testimony, they "evaluated the . . . Coral contract[], taking into account the peculiarities of product

Coral Agreement to the Commission's $74/MWh bench-

that they could not undertake a similar evaluation of the Sempra Agreement because the Sempra Agreement was

Pat WOOD, III, Chairman, *concurring in part:*

In voting on this order, I do not agree with the ALJ's interpretation that the case law is now clear that where a contract fails to specifically provide that the contract may be unilaterally altered, Mobile-Sierra automatically requires that proposed changes to

See Partial Initial Decision at P 28. I concur in the conclusion that the public interest standard of review applies to the contracts at issue in this case based solely on the specific evidence surrounding execution of those contract

William L. MASSEY, Commissioner, *dissenting*:

I am dissenting from this order, not because I relish abrogating contracts because I do not, but because I believe this Commission has a higher calling than simply the sanctification of long term contracts with prices reaching as high as $290 per MWh, contract prices that were multiples of traditional prices, shockingly high prices, completely unprecedented by historic standards. Our primary calling under the Federal Power Act is to ensure that prices are just and reasonable 24 hours a day, seven days a week. When prices soar to unprecedented levels, when prices exceed a just and reasonable level by multiples, we have the obligation to make it right. That is the way I read the law.

Many of the contracts challenged here provide for prices that are unlawful by any reasonable measure, and there is no persuasive public interest rationale for sanctifying contracts negotiated during the height of the Western electricity crisis, where the skyrocketing prices in an out of control spot market in California strongly influenced long term contract prices, wildly dysfunctional market conditions clearly allowed for the exercise of market power, and

on of the market according

Protecting contracts entered into in this horribly tainted

claration that contracts are absolutely unlawful and must be reformed if not just and reasonable. Turning Commission

electricity purchasers to "ride the spot market" because the Commission has shown a willingness to mitigate, and provide refund protection from, unjust and unreasonable spot market prices, at least in the California spot markets.[1] By the same token, buyers will be discouraged from forward contracting because they will not enjoy protection from unlawful contract prices. Power buyers, consumers and retail policymakers will lose faith in the concept of wholesale electricity markets if they cannot trust the Commission to protect them from unjust and unreasonable contract terms resulting from a wildly dysfunctional market, market power and epidemic market manipulation.

The J&R Standard Is The Appropriate Standard Of Review In This Instance

One of the fundamental questions that must be addressed in evaluating whether a contract must be reformed is the standard of review. Where there is clear language in the contract indicating that the parties intended that the "public interest" standard must be met before terms may be modified, then that is the appropriate standard. Where the contract lacks a clear statement of intent, the correct standard to apply is not that cl

the more stringent public interest standard must be satisfied even for contracts with no clear statement of intent. I do not agree.

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[1] In a case decided today, the Commission denies refund protection to spot market buyers in the Pacific Northwest during the crisis period. *Puget Sound Energy, Inc.*, 103 FERC ¶ 61,348 (2003).

It is my view that except where the contract has a *Mobile-Sierra* clause restricting the right of the buyer to file a Section 206 complaint, the just and reasonable standard applies. I concede that the law in this area is not the model of clarity, and the argument that the public interest standard controls is not without merit. Nevertheless, I

able rights must be explicit. As the Commission observed in Order 888-A:

> We note that the fact that a contract may bind a utility to a Mobile-Sierra public interest standard does not necessarily mean that the customer is also bound to that standard. Unless a customer specifically waives its Section 206 just and reasonable rights, the Commission construes the issue in favor of the customer.[2]

licy statement on standard of review is consistent with that position. The Commission would apply the just and reasonable standard of review unless specific language to the contrary is concluded in the contract.[3]

Perhaps more important, the just and reasonable standard should control the review of contracts negotiated *in the circumstances of this case* where the sellers were acting under a market-based pricing authorization granted by the Commission. The *Mobile-Sierra* doctrine arose in a cost-of-service regime. Once approved by the Commission as just and reasonable, a contract, rate or classification should not be modified unless a higher standard justifies the modification. This makes sense. Most cases arose in the context of a seller making a filing to justify a higher rate. In such a case, the doctrine appeared to have a customer protection rationale.

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[2] Order No. 888-A, *FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000* ¶ 31,048, at p. 30,191, footnote 31 (1997).

[3] *Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities*, 100 FERC ¶ 61,145 at P 7 (2002).

public utility to sell at prices set by the discipline of the market, based upon a finding that the seller cannot exercise or has mitigated market power, amounts to a "predetermination" that any contract negotiated by such seller is just and reasonable. Hence, according to the majority, the just and reasonable standard of Section 205 is satisfied, and a later contract modification would have to be justified by the higher public interest standard.

There are three flaws in this logic as applied here. First, virtually all of the

market based pricing authority to the public utility sellers in the West explicitly declared that the Commission's action could not be construed as approving any contract negotiated pursuant thereto. These orders say:

> (t)his action does not constitute approval of any service, rate, charge, classification . . . or any . . . contract . . . affecting such rate or service . . . , nor shall such action be deemed as recognition of any claimed contractual right or obligation affecting or relating to such service or rate; and such action is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding . . .

Based upon this language, it seems clear that these contracts have never been approved as just and reasonable under Section 205.

Second, even ignoring the rather plain language of the above-quoted paragraph, any possible presumption of the justness and reasonableness of contracts negotiated pursuant to the blanket authorization was flatly contradicted by the conclusions reached in the Commission's November 1, 2000 and December 15, 2000 Orders, and in the July 2001 Order requiring refunds. The November order found the market in California to be seriously flawed, and market

ntinue to have the potential to cause, unjust and unreasonable rates for short term energy." Further: "There is clear evidence that the California market structure and rules provide the opportunity to exercise market power when supply is tight and can result in unjust and unreasonable rates."[4] In the December 15 Order

unjust and unreasonable rates were charged and could continue to be charged, unle [5]

It should be clear from both the breathtaking rise in prices after the December order and the June 2001 intervention by the Commission that the remedies in the December order did not work. Effective remedies were not put in place until June 2001 when the Commission imposed full time price controls. I would also note that the Commis-

a functioning competitive market . . . unimpaired by market

[6] Circumstances indicate that this condition and presumption were not fulfilled. The Commission has found evidence of market manipulation in the California

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[4] *San Diego Gas & Electric Company*, 93 FERC ¶ 61,121, at p. 61,349 (2000).

[5] *San Diego Gas & Electric Company*, 93 FERC ¶ 61,294, at p. 61,999 (2000).

[6] *Reliant Energy Services, et al.*, 102 FERC ¶ 61,315 at P 12 (2003); and *Enron Power Marketing Inc., et al.*, 102 FERC ¶ 61,316 (2003).

markets and is also investigating whether sellers withheld power from the market or engaged in excessive bidding.

In light of all of these circumstances, the predetermina-

Order granting refunds for a nine month period beginning October 2, 2000 and ending June 19, 2001 was based upon a finding that during such period spot prices were not just and reasonable. It defies logi
nation" of justness and reasonableness contradicted by later Commission orders that reviewed real market conditions, found the opportunity to exercise market power, and required several billions of dollars in refunds based upon the explicit conclusion that actual prices charged in fact were not just and reasonable.

Third, the rates charged by sellers in the California spot markets were under the same regulatory scheme that produced the forward contracts at issue here, *i.e.*, a preliminary finding at the certificate stage that a seller lacked or had mitigated market power and, hence, rates sought to be charged by such seller would by definition be just and reasonable. This "predetermination" applied equally to spot prices and to long term contract prices. Yet, in July 2001 the Commission wisely and correctly decided to apply the just and reasonable standard to justify modifying the California spot prices and ordering refunds. Satisfying the public interest standard was not required. The Commission did not protect unjust and unreasonable spot prices (which were derived under tariff conditions and are akin to hourly contracts), yet decides today to protect unjust and unreasonable longer term transactions negotiated under the same regulatory framework. This distinction in the standard of review, based solely upon the length of the transaction, does not comply with Sections 205 and 206 of the Act, and in my view is not reasoned decision making.

There is an additional reason that the just and reasonable standard should govern in this case. It is obvious that

admonition in the December 2000 order that market participants enter into long term contracts.[7] In that same order, the Commission assured buyers that they would be protected from the exercise of market power. The Commission set a $74 MWh benchmark to use "in assessing any complaints regarding the justness and reasonableness of pricing of such long-term contracts negotiated under current market conditions."[8] The Commission promised to

just and unreasonable rates" in the long term markets.[9]

The buyers reasonably reli
declaration that complaints about long term contracts would be judged according to just and reasonable standards and they would be protected. Given that reliance, it is simply unfair to adopt a standard of review today that gives these buyers substantially less protection. In addition, after the Commission declared in December 2000 that $74 MWh was a just and reasonable benchmark for long term contracts negotiated thereafter, it seems unconscionable now to validate contracts that allowed sellers to fetch upwards of $250 MWh, $260 MWh, and $290 MWh—multiples of the benchmark. The Commission effectively said to buy-
s, $74 is a reasonable bench-
mark price and, hey, don't

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[7] ". . . those who remain in the spot market for buying their residual load or selling their residual supply should be there in full recognition of the effects on price of last minute sales and purchases." 93 FERC at p. 61,996.

[8] 93 FERC at p. 61,982.

[9] 93 FERC at p. 61,994.

utterly fails to keep that commitment.

The Nexus Between the California Spot Market and the Forward Contract Market

A second fundamental issue in this case is whether the dysfunctional California spot markets adversely affected the long-term bilateral markets. I frankly do not understand why the hearing order in this case treated this as an open issue, and I said so at the time. The relationship between the spot market prices and long term contract prices seems rather obvious, and the Commission has explicitly

market is the single most important element for disciplining longer term transactions."[10] In our Standard Market Design proposal, the Commission found that:

> Bilateral contracts generally reflect buyer and seller expectations of prices in spot markets. Therefore, market power mitigation in the organized spot market will effectively discipline market power in the bilateral markets as well [footnote omitted].[11]

More to the point, the Commission has specifically recognized the relationship between the California spot markets and bilateral markets in the West. Our November 1, 2000 order stated:

> Therefore, the operation of the California electricity market can affect prices throughout the entire Western Interconnection. The Staff Report demonstrates that during the summer of 2000 correlations between PX prices and Western bilateral prices were quite strong.[12]

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[10] *AEP Power Marketing*, 97 FERC ¶ 61,219, at p. 61,972 (2001).

[11] *Standard Market Design NOPR*, 100 FERC ¶ 61,138 at P 405 (2002).

[12] 93 FERC at pp. 61,357-358.

And our June 19, 2001 mitigation order recognizes that

the ISO's organized spot markets, the prices in the bilateral spot markets in California and the rest of the West, and the

[13] Thus, it is beyond comprehension why there is any doubt on this issue.

But if there was any doubt whatsoever regarding whether there was a nexus between the spot and forward

rkets Report should dispel

nificant relationship between spot and forward power prices during the period January 1, 2000 through June 30, 2001.[14] The contracts at issue here were negotiated during this

sis. It was performed by a nationally recognized econometrician with a specialty in energy futures markets and with access to the most comprehensive database of forward power contracts for the period and locations in question. Thus, based on logic, the Co

yond dispute that the prices and other terms of the forward contracts at issue here were influenced by the California spot markets.

The Just and Reasonable Standard Is Met

The prices and other terms of the forward contracts at issue here are unjust and unreasonable and should be reformed. I base this conclusion on three factors. First, the Commission has found that the California spot markets resulted in unjust and unreasonable rates for the refund period (October 2, 2000 to June 19, 2001). This is the period during which the contracts at issue here were negotiated. Second, the California markets were subjected to various forms of manipulation, which may have included withholding.[15] Third, there was a clear nexus between the California spot market and the forward contract markets. The unlawful California spot prices strongly influenced forward contract prices. And fourth, the prices in many of these contracts are multiples of the $74 MWh price the Commission had declared would be used as a rough just and reasonable benchmark.

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[13] *San Diego Gas & Electric Company*, 95 FERC ¶ 61,418, at p. 62,547 (2001).

[14] Western Markets Report at VI-18.

The Public Interest Standard Is Met

Even if the majority is correct and the appropriate standard of review is the public interest standard, these agreements still do not withstand scrutiny and must be reformed. The tone of today's order is that the *Mobile-Sierra* line of cases places a thumb heavily on the scale in favor of sanctity of contracts, and thus sets an exceptionally high threshold in meeting the public interest standard. While the thresh-

place it for the particular contracts at issue.

The *Mobile-Sierra* case law involves contracts negotiated under a cost-of-service regime, and thus we do not know how the courts would instruct the Commission to address contracts negotiated in a market-based regime, especially under market conditions characterized by dysfunctional market rules, widespread manipulative conduct, and a lack of effective regulatory oversight. We are on new ground here, and the Commission is free to decide what circumstances give rise to the public interest.[16] We are clearly not limited to the traditional three-prong test that gets so

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[15] *See Enron Power Marketing, Inc., et al.*, 103 FERC ¶ 61,343 (2003) where the Commission revokes the market-based authorities and terminates the blanket marketing certificates of various Enron affiliates. *See also, American Electric Power Service Companies, et al.*, 103 FERC ¶ 61,345 (2003), *Enron Power Marketing, Inc. et al.* (2003) and *Investigation of Anomalous Bidding Behavior and Practices in the Western Markets*, 103 FERC ¶ 61,347 (2003) where the Commission establishes proceedings to investigate manipulative and questionable bidding behavior.

point out that those three factors are only examples of what to consider in determining the public interest.[17] Indeed, the Commission has great discretion in carrying out its statutory responsibilities, even where the public interest standard controls:

> ... even if contracts fall within the scope of the Mobile-Sierra decisions, the Supreme Court has emphasized that the relevant agency, here FERC, may
>
> *i.e.*
>
> remain fully subject to the paramount power of the Commission to modify them when necessary in the
>
> [18]

The Commission's order setting this case for hearing implicitly recognized our discretion in evaluating these contracts under the public interest standard when it held that "the Commission will not modify market based contracts

[19] We are in-

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[16] "... nowhere in the Supreme Court opinion is the term 'public interest' defined. Indeed, the Court seems to assume that the Commission decides what circumstances give rise to the public interest." *Northeast Utilities Service Company v. FERC*, 55 F.3d 686, 690 (1st Circuit 1995).

[17] "This definition of what is necessary in the public interest was formulated in the context of a low-rate case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases." *Northeast Utilities*, 55 F.3d at 690. *Also see* today's order at P 5.

[18] *Northeast Utilities*, 55 F.3d at 693.

[19] *Public Utilities Commission of California v. Sellers of Long Term*

w)hen there is no reason to question what occurred at the contract formation stage, the [20]

whether there were extraordinary circumstances at play during the contract formation stage that warrant contract reformation.

In evaluating whether to reform contracts involving a seller with market-based authority, we must be guided by the market circumstances that affected the negotiations and contract terms. It has already been established that the conditions in the California markets infected markets across the West, including the forward contracts, such as those at issue in this case. What were the circumstances under which buyers negotiated these contracts?

> flawed, market power could be exercised in them, unjust and unreasonable rates had been charged and the potential existed that unlawful rates could be charged in the future. This is what the Commission found in November and December of 2000.
>
> of electricity that resulted in unprecedented, high, volatile, and unjust and unreasonable prices in the spot markets. As a result, the Commission admonished buyers to move load into forward contracts or suffer the consequences.
>
> was manipulated through a number of strategies by sellers. These are documented in the Western Mar-

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Contracts, 99 FERC ¶ 61,087, at p. 61,383 (2002).

[20] *Town of Norwood v. FERC*, 587 F.2d 1306, 1312 (D.C. Cir. 1978).

kets Report and in orders decided today where the Commission requires more than fifty power sellers to defend against charges that they engaged in one or more manipulative strategies to pump up electricity prices.[21] The Commission is still investigating whether generation was strategically withheld from the market.

the fuel input for the marginal generation resources in the West, was manipulated by epidemic false reporting. This is documented in the Western Markets Report.

to expect that this Commission would act forcefully to control them. The measures imposed in the December 2000 Order were clearly ineffective and prices continued to rise. The Commission approved as just and reasonable spot prices of $273 MWh, $430 MWh and $300 MWh for the first three months of 2001, respectively,[22] and the Commission's then chairman reportedly advised Californians at the time that the

shovels in the ground."[23]

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[21] *See American Electric Power Service Companies, et al.*, 103 FERC ¶ 61,345 (2003), *Enron Power Marketing, Inc. et al,* (2003) and *Investigation of Anomalous Bidding Behavior and Practices in the Western Markets*, 103 FERC ¶ 61,347 (2003) where the Commission establishes proceedings to investigate manipulative and questionable bidding behavior.

[22] *See respectively*, 94 FERC ¶ 61,245 (2001), 94 FERC ¶ 62,245 (2001), and an unpublished *Notice of Proxy Price for April Wholesale Transactions in the California Wholesale Electric Market* issue by the Director, Office of Markets, Tariffs and Rates, April 16, 2001.

[23] Statement attributed to Chairman Hebert, San Francisco Chronicle, April 12, 2001 (as reported on the San Francisco Chronicle's web site –

This is the unprecedented environment in which these contracts were negotiated. The economic signals that formed the basis of the negotiations, and consequently the contract terms, were severely tainted. Buyers had their backs to the wall under these circumstances and essentially negotiated out of fears of yet higher prices or blackouts for their customers. Such conditions, spread over an area as large as the western United States, are truly extraordinary. And those conditions had extraordinary effects. For example:

cap prices across this entire thirteen state region, 24 hours a day, seven days a week.[24] Such broad market intervention by this agency was unprecedented.

- A major California utility, Pacific Gas and Electric, declared bankruptcy as a direct result of the crisis and a second utility, Southern California Edison, teetered on the edge of bankruptcy.
- Local economies suffered devastating effects as a result of these market conditions. In the Pacific Northwest, factories closed and jobs were lost. The aluminum industry has exited the region for all intents and purposes.

kets at the national and state levels was almost brought to a halt. Consumers and policymakers were shocked and outraged that an out of control electricity market could wreak such havoc.

The tainted atmosphere in which these contracts were negotiated was unprecedented and extraordinary. The

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<www.sfgate.com>).

[24] *San Diego Gas & Electric Company*, 95 FERC ¶ 61,418 (2001).

most influential benchmark used in negotiating forward

pectations of future spot prices—was wildly dysfunctional. When these contracts were negotiated, the Commission had already declared that conditions in the California markets allowed the exercise of market power and rates were unjust and unreasonable. And we now know that there was unprecedented manipulation of both the natural gas and electricity markets and epidemic false reporting of natural gas trading data.

There is simply no persuasive public interest rationale for protecting and sanctifying contracts negotiated in this unprecedented and extraordinary environment. Those market conditions certainly tainted any contracts negotiated during this time frame. It would simply defy logic to conclude that the high prices in these contracts were not adversely influenced by market conditions that included the exercise of market power and widespread market manipulation. Upholding such contracts violates the public interest. These contracts must be reformed.

Remedy

I would remand this case to an Administrative Law Judge to determine specifically how each contract should be reformed. I would also recommend that the judge use the

Western Markets Report for determining the mitigated price in each contract. I suggest

had access to the most comprehensive data base of forward price contracts for the period and locations in question.

lationship between spot power prices and forward contract

shows how much forward prices rise for each percentage increase in spot prices. Staff also developed a formula representing the relationship between the degree to which spot power prices were excessive and the appropriate level for mitigated forward prices. This formula can be used to set mitigated forward contract prices. The excessiveness of

lation) can be estimated by using the mitigated market clearing prices (MMCPs) being developed in the California refund proceeding. The MMCPs will represent the just and reasonable prices in the California spot markets. The spot

develop the mitigated forward prices.[25]

For these reasons, I dissent from today's order.

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[25] *See* pages V-16 to V-18 of the Western Markets Report.

Nora Mead BROWNELL, Commissioner, *concurring:*

1. I have been very clear in my prior statements about my belief in the sanctity of contracts. However, the issue of how to weigh contract sanctity in the context of the Western power crisis is, to say the least, a very difficult one, and I have struggled with it. The parties in this case were afforded the opportunity of a trial-type hearing and I have reviewed the evidence developed during that hearing. I

Final Report on Price Manipulation in Western Markets and the evidence submitted in the 100-Day Discovery Proceeding in the context of this case. Finally, the Commission took the unusual step of providing the parties an additional opportunity to address the issues in an oral argument before the Commission itself, and I have carefully considered all points raised during that oral argument. After reviewing all of this information, I agree with the

tered into and the Complainants have not met their burden of proving that the contracts are contrary to the public interest.

2. I am writing separately to express my concern about one aspect of the order: the rationale for concluding that modification of the contracts is subject to the public interest standard of review. When these cases were set for hearing, I noted that existing judicial case law seemed to indicate that the public interest standard applied to all of these contracts based solely on the

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[1] *Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al.*, 99 FERC ¶ 61,087 (2002) (*citing Texaco Inc. v. FERC*, 148 F.3d 1091, 1096 (D.C. Cir. 1998) and *Boston Edison Co. v. FERC*, 233 F.3d 60,

Nevertheless, I was willing to set the issue for hearing so that the parties and the ALJ could have an opportunity to further explore whether my understanding of the case law was accurate. Three ALJs have now independently come to the same conclusion: judicial case law establishes that in the absence of clear contractual language allowing unilateral contract modification, the party seeking the change must meet the public interest standard.[2]

3. This order could have simply affirmed the ALJ's conclusion on this point and ended there the analysis of which standard to apply. That is what I am voting to do. Unfortunately, today's order fails to do so and instead bases the finding of the applicable standard on an analysis of the extrinsic evidence that parties did or did not present at hearing. By doing so, the order ignores the law. The *Mobile-Sierra* doctrine is not an invention of the FERC that we are free to mold as we wish; it is a directive from the Supreme Court. Moreover, the order misses an opportunity to provide clarity and certainty to all market participants and leaves open the possibility that the Commission may order unnecessary fact-finding on the

ract abrogation cases.

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67 (1st Cir. 2000)).

[2] *Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al.*, 102 FERC ¶ 63,013 at P 28 (2003); *Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing, L.L.C., et al.*, 101 FERC ¶ 63,031 at P 27 (2002); and *PacifiCorp v. Reliant Energy Services, Inc., et al.*, 102 FERC ¶ 63,030 at P 18 (2003).

APPENDIX D

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[¶ 63,013]

Public Utilities Commission of the State of California

v.

Sellers of Long Term Contracts to the California Department of Water Resources

Docket No. EL02-60-003

California Electricity Oversight Board

v.

Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources

Docket No. EL02-62-003

(Consolidated)

Partial Initial Decision on the Issue of the Applicable Standard of Review

(Issued January 16, 2003)

Bobbie J. McCartney, Presiding Administrative Law Judge.

Introduction

1. By Order dated January 10, 2003 (*January 10 Order*),[1] the Commission directed the undersigned presiding administrative law judge to determine the applicable standard of review for the contracts at issue in this consolidated proceeding not containing explicit *Mobile-Sierra* language, and as to the contracts for which the undersigned ALJ finds the applicable standard of review to be the

rtify the record directly to the Commission for consideration of all remaining issues in the case. In accordance with

Order, this is a partial initial decision limited to the single threshold issue of the applicable standard of review for the subject contracts.

Background

been filed with the Commission and served on all parties on the Restricted Service List, contains a good summary of the procedural history of this case and is adopted and incorporated herein in pertinent part.

3. On February 25, 2002, the Public Utilities Commission of the State of California (CPUC) and the California Electricity Oversight Board (CEOB) (jointly referred to as

identical, complaints seeking to modify over 30 contracts.[2] The contracts at issue are long-term contracts between the California Department of Water Resources (CDWR) and numerous sellers[3] of energy. The Complainants claimed that the prices, terms and conditions of these contracts are unjust and unreasonable and, to the extent applicable, not in the public interest. The Complainants also alleged that these sellers obtained the prices, terms, and conditions in the contracts through the exercise of market power in violation of the Federal Power Act (FPA), and the sellers' actions are causing injury to the citizens and ratepayers of California.

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[1] *Public Utils. Comm'n of California v. Sellers of Long Term Contracts*, 102 FERC ¶ 61,025 (2003). (January 10 Order).

[2] A list of the contracts which the Complainants sought to modify is contained in Appendix A to the April 25, 2002 Order.

4. On April 25, 2002, (April 25 Order), the Commission issued an order dismissing the complaints as to contracts

effect, . . . since the effect of the West-wide mitigation was

ng the complaints for hearing

as to those contracts entered into before June 20, 2001.[4] As to those contracts, the Commission established an evidentiary hearing to address:

> whether the dysfunctional California spot markets adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue is warranted. The hearing will not address
>
> ing market-based rate authority or on regulation of sellers with such authority. Further, if the judge concludes that modification of one or more of the contracts is warranted, the judge should not attempt at this stage to determine how those contracts should be modified.

99 FERC at p. 61,384 (footnote omitted).

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[3] A list of the sellers is contained in Appendix B to the April 25, 2002 Order.

[4] *See* April 25, 2002 Order.

5. Furthermore, the Commission specifically limited the scope of the evidentiary hearing to matters other than market manipulation and the exercise of market power by noting that it had previously issued an order on February 13, 2002, directing a full staff investigation of potential manipulation of electric and natural gas prices in the West. In explaining the difference in the two proceedings, the Commission stated:

> We are setting the instant contracts for hearing under Section 206 of the FPA based on the arguments that the dysfunctional spot markets in California caused long-term contracts not to be reasonable, whereas the investigation is looking at whether there was improper behavior by sellers that may have caused prices not to be reasonable.

Id. at p. 61,383, n. 28.

ber 6, 2002, designating the undersigned as the presiding administrative law judge (ALJ) in this proceeding and establishing hearing procedures, the undersigned ALJ convened a number of pre-hearing conferences to address discovery disputes, motions to strike, and related issues regarding the scope of the evidentiary hearing, consistently ruling that, based on the Commission's Orders, the issue of alleged exercise of market power was not within the scope of the issues set for hearing in this proceeding. Tr. at 207:7-10. These rulings were further clarified during a pre-hearing conference held on November 19, 2002, reflecting the view of the undersigned ALJ that, by excluding the issue of alleged exercise of market power in the instant proceedings, the Commission sought to provide the State with an opportunity for expedited review of the subject contracts based on the less arduous showing that the dysfunctional spot markets in California caused long-term contracts not to be reasonable; that is, to pursue their complaint allegations without the added burden of having to prove allegations of exercise of market power as the basis for seeking modification of the subject contracts. Tr. at 547:7-551:17.

7. In point of fact, on November 20, 2002, the Commission issued an order allowing the State to conduct discovery into market manipulation by various sellers during the Western power crises of 2000 and 2001.[5] In the view of the undersigned ALJ, this Order underscored the need to limit the scope of the subject proceedings to that proscribed by the Commission to ensure that this expedited proceeding would not interfere with the ongoing Staff investigation in Docket No. PA02-2-000. Accordingly, this point was reiterated on the record the first day of the hearing, which commenced on December 2, 2002, as follows:

> the state insists on trying to create a burden for itself that it does not have in this case. The state does not have to prove that there has been the exercise of market power to establish the threshold issue of whether the dysfunctional California spot market adversely impacted long-term bilateral markets. I do not know why the state continues to try at every turn to insinuate into this hearing exercise of market power issues when the Commission has specifically proscribed that area with respect to this proceeding. The state is well aware that there is a full investigation ongoing that is going to address that specific issue. Tr. at 797: lines 4-16.

8. Nevertheless, the parties were permitted to have any evidence excluded from the record as a result of these rulings considered by the Commission as an offer of proof.

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[5] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator Corp.* and the *California Power Exchange*, 101 FERC ¶ 61,186 (2002) (November 20 Order).

Further, in accordance with
Order, the parties were provided with an opportunity to present a wide range of facts and data in support of their cases, including evidence pertaining to negotiations of contract terms and the availability of other alternatives to both buyers and sellers, as well as the relation of the contract
iously identified benchmark
for long-term bilateral contracts. *Id.* at p. 61,384.

9. In addressing the standard of review to be applied to the contracts at issue given the extraordinary remedy of contract modification sought by the Complainants, the Commission reiterated its long-standing policy of upholding the sanctity of contracts and stated that it would not modify market-based contracts absent extraordinary circumstances. 99 FERC at p. 61,383. The Commission then made an initial determination that for certain contracts that contained explicit *Mobile-Sierra* language, the Complainants would have to satisfy the *Mobile-Sierra* public interest standard[6] to justify modification of the contracts. 99 FERC at p. 61,383. The parties whose contracts contained the explicit *Mobile-Sierra* language included: Allegheny Energy Supply Company, L.L.C. (Allegheny); Mirant Americas Energy Marketing, L.P. (Mirant); and Coral Power, L.L.C. (Coral).[7]

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[6] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (*Mobile*); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*).

[7] Other contracts in this category included: Williams Energy Marketing & Trading Company (Williams); Soledad Energy, LLC (Soledad); and GWF Energy, L.L.C. (GWF). These contracts are no longer at issue in this proceeding because the parties have reached a settlement and the complaints against these parties have been withdrawn. Notice of withdrawal regarding the Soledad contract was filed on July 12, 2002, and a notice of withdrawal regarding the GWF contract was filed on September 4, 2002. By Order of the Chief Judge dated November 26,

10. For the contracts that did not contain an explicit *Mobile-Sierra* provision, the Commission ruled that it needed additional information in order to determine the applicable standard of review for these contracts. *Id.* The sellers whose contracts did not contain explicit *Mobile-Sierra* language included: El Paso Merchant Energy, L.P. (EPME); Dynegy Power Marketing, Inc. (Dynegy); Morgan Stanley Capital Group, Inc. (MSCG); and Sempra Energy Resources (Sempra).[8]

11. On July 23, 2002, (July 23 Order), the Commission issued its Order on Rehearing, reaffirming its decision to dismiss the complaints related to contracts entered into after June 20, 2001, granting rehearing and dismissing complaints as to two qualifying facilities, and denying all other requests for rehearing and clarification.[9] In this Order, the Commission reiterated its position that it needed additional information in order to determine the applicable standard of review for contracts that did not contain explicit *Mobile-Sierra* language. According to the Commission, "[t]he evidentiary hearing was established to, among other things, interpret the terms of the contracts at issue and to ascertain the intent of the parties at the time the contracts were signed." 100 FERC ¶ 61,098 at P 12.

2002, the proceeding as to Williams was suspended pending finalization of the parties' settlement agreement.

[8] Other contracts in this category included: Imperial Valley Resource Recovery Company, L.L.C. (Imperial Valley) whose contract was dismissed in the Commission's Order on Rehearing (100 FERC ¶ 61,098, at P 19); Alliance Colton, L.L.C. (Alliance Colton); and PG&E Energy Trading-Power, L.P. (PG&E Energy Trading). Notices of withdrawal of the complaint as to Alliance Colton and PG&E Energy Trading were filed on September 30, 2002 and October 3, 2002, respectively.

[9] *Public Utilities Commission of the State of California, et al., v. Sellers of Long Term Contracts, et al.*, 100 FERC ¶ 61,098 (2002) (July 23 Order).

12. The parties simultaneously filed their direct testimony and exhibits on October 17, 2002. The Staff filed its direct testimony and exhibits on November 8, 2002, and the parties filed their rebuttal testimony and exhibits on November 14, 2002. Pre-hearing Briefs were filed on November 25, 2002. The hearing began on December 2, 2002 and concluded on December 12, 2002.

13. On October 29, 2002, Allegheny filed an emergency motion for summary dismissal of the State's complaints as to its contracts. By Order dated December 17, 2002 (December 17 Order) the Commi
emergency motion; however, to expedite resolution of the proceeding as to Allegheny and other parties whose contracts contained explicit *Mobile-Sierra* provisions, the Commission directed the undersigned ALJ to omit the initial decision on this issue, and certify the record directly to the Commission.[10] In accordance with the Commission's December 17 Order, on December 24, 2002, the undersigned ALJ certified the record for this proceeding directly to the Commission as to Allegheny, Coral, and Mirant and proceeded to evaluate the record for the purpose of preparing an initial decision regarding the contracts for the remaining sellers.[11]

14. By motion filed on December 19, 2002, Dynegy, EPME and SER, and MSCG by motion filed on December 26, 2002, (together, Indicated Respondents or Sellers), moved for partial summary disposition on the standard of

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[10] *Public Utilities Commission of the State of California, et al., v. Sellers of Long Term Contracts, et al.*, 101 FERC ¶ 61,293 (2002) (December 17 Order).

[11] *Public Utilities Commission of the State of California, et al., v. Sellers of Long Term Contracts, et al.*, 101 FERC ¶ 61,034 (2002). *See also* Errata Notices dated 12/31/02 and 1/10/03.

review applicable to their long-term contracts with the CDWR, (together, the Indicated Contracts).[12]

15. By Order dated January 10, 2003 (January 10 Order),[13] the Commission ruled on the subject motions by directing the undersigned ALJ to determine the applicable standard of review for the contracts not containing explicit *Mobile-Sierra* language, and as to the contracts for which the undersigned ALJ finds the applicable standard of review to be the "public interes

cord directly to the Commission for consideration of all remaining issues in the case.

Position of the Parties and Staff

16. In their joint Prehearing Brief submitted on November 25, 2002,[14] the Complainants attempted to argue that the "public interest" st

this proceeding. Complainants' Prehearing Brief at 44, 47-49. However, in the December 17 Order, the Commission rejected this position stating:

> The fact that a contract may be found to be unjust and unreasonable under Sections 205 and 206 of the Federal Power Act does not in and of itself demonstrate that the contract is contrary to the public in-

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[12] Specifically, the Indicated Contracts are: (a) the Energy Purchase Agreement (the SER Agreement), dated May 4, 2001, by and between CDWR and SER, Exh. SER-2; (b) the February 13, 2001 Contract between EPME and CDWR (EPME Contract), Exh. EPME-29; (c) the System Contingent Capacity Purchase and Sale Agreement (the Dynegy Agreement), dated March 2, 2001, by and between CDWR and Dynegy, Exh. DYN-2; and (d) the February 14, 2001 Contract between MSCG and CDWR (MSCG Agreement), Exh. MSC-2.

[13] See *Public Utils. Comm'n of California v. Sellers of Long Term Contracts*, 102 FERC ¶ 61,025 (2003). (January 10 Order).

[14] Trial Brief on Behalf of the California Electricity Oversight Board and the California Public Utilities Commission, Docket Nos. EL02-60, *et al.* (November 25, 2002).

terest under the Supreme Court cases. Accordingly, we instruct the parties to apply the correct legal standards in developing this case and making their arguments.[15]

17. Complainants further propound that the holdings in *Mobile* and *Sierra* precluded the sellers from seeking damages in contractually agreed upon prices for their own benefit, but left intact the paramount duty of the Commission to protect the public interest. *Id.* Complainants conclude that applying the "correct legal standard" under *Mobile-Sierra* thus requires the Commission to determine whether the challenged contracts adversely affect the public interest. I.B. at 16.

18. Further, Complainants attempt to distinguish be-

in the instant case,
agency purchasing power solely for the benefit of the public. *Id.* at 16-17. Thus, the State claims that under *Mobile-Sierra*, where the rates are borne directly by the
Mobile-
Sierra
it is contrary to the public interest to charge unlawful rates to the public. *Id.* at 19.

19. The joint position of the Indicated Respondents is that, like the sellers with explicit *Mobile-Sierra* language contained in their contracts, they too are protected under the *Mobile-Sierra* doctrine and may have their contracts modified "only if the public
ents Joint I.B. at 7-8. Respondents cite extensive precedent for the proposition that the law is clear that, absent

laterally seek a change in the contract, the *Mobile-Sierra* doctrine applies. *Id.* at 9-10. Respondents also cite the recent Nevada Power ID, where Judge Cintron found that fixed forward contracts were to be reviewed under the *Mobile-Sierra* public interest standard. *Id.* Respondents note that none of the subject contracts contain provisions for the State to seek unilateral changes to the contracts under Section 206, and therefore argue that the public interest standard of review applies to these contracts. *Id.* at 11. Respondents also note that Staff Witness Natalie Tingle-Steward reviewed the challenged contracts and found that none of the contracts permit unilateral application to the Commission for rate changes. *Id.*

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[15] *Id.* at 6.

20. Respondents cite the unrebutted testimony of Respondents' witnesses who testified that in each contract, either the Seller or the State insisted on language that would ensure that either the State would not seek abrogation of the contract or that the Commission would be precluded *Id.* at 11-12.

tion that the public interest standard and the just and reasonable standard impose the same burden. *Id.* at 13. Respondents emphasize that the *Mobile-Sierra* doctrine protects the public at large rather than the direct benefit of the seller and purchaser, which applies the just and reasonable standard, and therefore it cannot be waived or eliminated by agreement of the parties. *Id.* Moreover, Respondents opine that applying the public interest standard of review is fully consistent with the statutory requirements of the Federal Power Act (FPA) because a contract with a mutually agreed-upon fixed rate satisfies the just and reasonable standard unless the challenging party can show that the public interest compels a contrary result. *Id.* at 14.

22. Intervenor, Universal Studios, took the position that the State has only the burden of showing, in the next phase of the case, that the contracts

U.S. I.B. at 13. Universal Studios submits that a private contract no matter how valid,

which requires that all rates and charges be "just and rea-

Id. Universal Studios cites the testimony of

Commission has the power to review contracts to determine whether they are just and reasonable. *Id.* at 15-16. Universal Studios concludes that no credible evidence supports a finding that the State, as surrogates for the consumers of California, have any higher burden than to show that the

Id. at 16. Universal Studio[s] argues that for market-based rates to be just and reasonable, they must be "within the same 'zone of reasonableness' as cost-based

citing Farmers Union Cent. Exch. Inc. v. FERC, 734 F.2d 1486, 1530 (D.C. Cir. 1984), *cert. denied sub nom. Williams Pipe Line Company v. Farmers Union Central Exchange, Inc.*, 469 U.S. 1034 (1984); and *San Diego Gas & Elec. Co. v. Sellers of Energy*, 93 FERC ¶ 61,294, at p. 61,998 (2000), *order on reh g*, 95 FERC ¶ 61,418 at p. 62,559 n.52 (2001). Exh. US-1 at 11:7-24.

23. Commission Trial Staff explains that where a contract fails to specifically provide that the contract may be altered, *Mobile-Sierra* requires that proposed changes meet the public interest standard. *Id.* at 14. Staff cites recent Commission findings that hold that the public interest standard applies to both buyer and seller, and that lan-

changes under Section 205 was an implicit waiver of the buyer's right to do so under Section 206. *Id.* at 16. Staff points out that the Commission has recently emphasized that it does not take contract modification lightly, which was also asserted in Commission Orders granting the hearings on both the Nevada Power and the instant dockets. *Id.*

24. Trial Staff disputes the Complainants' public/private distinction in the *Mobile-Sierra* line of cases, pointing out that even as recently as the December 17 Order, the Commission stated that just because a contract may be found to be unjust and unreasonable under the FPA, does not without more, demonstrate that the contract is contrary to the public interest. *Id.* at 19. Staff concludes that, after a review of each of the four remaining contracts and the record, the *Mobile-Sierra* "public interest" standard applies. *Id.* at 20.

Discussions and Findings

25. Commission Trial Staff's Initial Brief, which has been filed with the Commission and served on all parties on the Restricted Service List, contains an excellent summary of the case law and evolution of the Commission's policy regarding the *Mobile-Sierra* doctrine and is adopted and incorporated herein in pertinent part.

1. *Applicable Case Law and Commission Precedent*

26. The Federal Power Act provides two methods for changing wholesale electric rates and related terms and conditions. Under Section 205, a utility may initiate rate changes by making a filing with the Commission. Under Section 206, any party (or the Commission on its own motion) may request a prospective change in an existing rate upon a finding by the Commission that the existing rate is unjust, unreasonable, unduly discriminatory or preferential.

27. The Federal Power Act, however, does not preclude utilities and their customers *inter se* from prescribing rates contractually. The interplay between the rights of parties to set rates among themselves and the Commission's power to change those rates was first examined in 1956 by the Supreme Court in separate decisions under the Federal Power Act and the Natural Gas Act. In *Mobile*, a supplier of natural gas sought to unilaterally increase the rate of a contract filed with the Commission. The Supreme Court

held that the Natural Gas Act does not empower natural gas companies unilaterally to change their contracts. This Court went on to say that by "preserving the integrity of contracts, it permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry . . . The contracts remain fully subject to the paramount power of the Commission to modify them when

[16] In *Sierra*, the Court extended to proceedings under the Federal Power Act its holding that fixed-price contracts could not be unilaterally modified. However, in light of the allegations that the contractual rate produced less than a fair return to the utility, the Court added that the Commission was empowered under Section 206 to modify a contract rate

- [17] Two years later, the Court further delineated the relationship between the Commission's power to change rates and the parties' rights to set them contractually in *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div.*, 358 U.S. 103 (1958) (*Memphis*) making it clear that just as parties may enter into contracts which specifically contemplate unilateral rate change filings, as in *Memphis*, they may contractually eli-

life of the contract.

28. Further, and perhaps more importantly for purposes of determining the applicable standard for the subject contracts, the case law is now clear that where a contract fails to specifically provide that the contract may be unilaterally altered, *Mobile-Sierra* requires that proposed changes meet the public interest standard. In *Texaco Inc. v. FERC*, 148 F.3d 1091, 1096 (D.C. Cir. 1998), the court

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[16] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

[17] *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956).

held that notwithstanding the fact that the agreement was silent on the issue, the Commission was precluded from ordering alterations of rate design for reasons other than the public interest. The court also clarified its position with respect to its prior ruling in *Papago*:

> The court [in *Papago*] did not suggest that the
>
> would leave it intact. The law is quite clear: absent
> ible to the construction
> that the rate maybe altered while the contract sub-
> *Mobile-Sierra* doctrine applies.

148 F.3d at 1096 (footnotes omitted).

29. More recently, in *Boston Edison Co. v. FERC*, 233 F.3d 60 (1st Cir. 2000), the court affirmed the position that, in the absence of clear contractual language allowing contract modifications under Section 206, the Commission is bound by the public interest standard:

> [T]he specification of a rate or formula by itself implicates *Mobile-Sierra* (unless the parties negate the implication) and that a generally framed boilerplate clause . . . does not constitute such a negation.
>
> * * *
>
> . . . FERC should stop trying to rewrite deals that the parties have already made under the aegis of *Mobile-Sierra* unless it properly makes the public interest standard.

Id. at 67 and 68 (footnotes omitted).

30. The Commission has also applied the same standard
San Diego
Gas & Electric Company v. Public Service Company of New Mexico, 91 FERC ¶ 61,233 (2000), the Commission held a buyer to the public interest standard, notwithstanding the fact that the contract was silent as to the buyer's

Section 206 rights and "the evidence introduced at the hearing similarly reflected that the parties did not ever discuss either Section 206 or the applicable standard of review were a Section 206 complaint to be filed." 91 FERC at p. 61,852. The Commission in essence interpreted the language in the contract as restricting the seller's right to seek certain unilateral rate changes under Section 205 as an implicit waiver of the buyer's right to do the same under Section 206. *Id.*

31. While it is important to recognize that the *Mobile-Sierra* doctrine arose in the context of a completely regulated environment, where, as here, the contracts were entered into under the parties' market-based rate authority, the Commission has stated that "[p]reservation of the contracts has, if anything, become even more critical." 99 FERC at p. 61,383.

2.

To These Contracts

32. The Commission is, of course, already fully aware that under current case law where a contract fails to specifically provide that the contract may be unilaterally altered, *Mobile-Sierra* requires that proposed changes meet the public interest standard. As Commissioner Brownell noted in her concurring opinion setting this matter for hearing:

> I see nothing in the *Mobile-Sierra* case law that bars the Commission from ruling that a market-based contract's silence on a buyer's rights to seek unilateral changes under Section 206 of the Federal Power Act triggers the public interest standard.

99 FERC at p. 61,388.

33. Nevertheless, with respect to the contracts involving Dynegy, EPME, MSCG, and Sempra that did not contain an explicit *Mobile-Sierra* provision, the Commission established an evidentiary hearing to, among other things, "interpret the terms of the contracts at issue and to ascertain the intent of the parties at the time the contracts were

signed." 100 FERC ¶ 61,098 at P 12. Accordingly, it is clear to the undersigned ALJ that the Commission is attempting to provide the State with every opportunity to establish through extrinsic evidence that the parties intended a different standard to apply to the subject contracts.

34. The evidentiary record in this proceeding closed on December 12, 2002. The parties filed Initial Briefs on January 10, 2003. But the State just now acknowledges that it has not been able to justify the application of a different standard to the Indicated Contracts based on the absence of an explicit *Mobile-Sierra* provision in the remaining four contracts.[18] Nevertheless, as a convenience to the Commission, a summary of the evidence of record on this issue may still be helpful.

35. The evidence of record proffered by the contracting parties regarding intent of the parties as it pertains to unilateral filing rights under the subject Indicated Contracts, other than the express language of the Indicated Contracts themselves, has been summarized by the Sellers in their January 10, 2003 Joint Initial Brief as follows: Exh. SER-1 at 34:6-36:14 (Niggli); Exh. SER-32 at 6:17-7:5 (Niggli); Exh. SER-34; Exh. SER-35; Exh. SER-55; Exh. SER-56; Exh. DYN-1 at 12:10-12, 26:15-18, 31:23-32:24, 33:10-34:5 (Lednicky); Exh. DYN-40 at 16:3-6 (Lednicky); Exh. MSC-1 at 9:12-18 (Hamdan); Exh. S-1 at 6:15-8:17, 11:1-11, 15:12-19:2 (Forman); Exh. S-4 at 6:11-15:14 (Tingle-Stewart); Exh. CAL-181 at 308:12-25 (Freeman); Tr. at 1633:8-1637:6 (Hart); Tr. at 2292:16-2293:6 (Smith); Tr. at 2476:5-2482:6 (Forman); Tr. at 2486:8-21 (Forman). In addition to the contracting parties, Sellers note that intervenor Universal Studios submitted testimony on Universal's

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[18] January 14, 2003, Answer of California Public Utilities Commission and California Electricity Oversight Board to Motion to Hold Briefing in Abeyance.

understanding of its rights regarding this issue, Exh. US-1 at 13:3-14:16 (Thomas), and sought to elicit testimony on cross-examination of certain witnesses for the Sellers and the Staff as to whether they thought the contracts authorized sellers to charge unreasonable rates under Section 205 of the Federal Power Act, see, *e.g.*, Tr. at 2143:13-2149:11 (Lednicky); Tr. at 2293:8-15 (Smith); Tr. at 2458:4-7 (Forman).

36. A complete discussion of the cited evidence of record is also provided by the Sellers in their Joint Initial Brief, but will not be repeated here. However, Commission Trial Staff's analysis of each of the four remaining contracts considered in the context of this record evidence provides a useful framework for the Commi

issue of the applicable standard of review and is therefore adopted and incorporated herein as follows:

a. *Dynegy Contract*

37. The Dynegy contract with CDWR, dated March 2, 2001, was established pursuant to the Edison Electric Institute Master Power Purchase and Sale Agreement (EEI Master Agreement),[19] and filed with the Commission on November 21, 2001 in Docket No. ER01-1718-000. Exh. CAL-32. It was accepted for filing on January 18, 2002. Exh. S-4 at 10:16-19. There is no provision in this contract

206 rights. However, Section 8, Paragraph F of the System

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[19] As Staff witness Ms. Tingle-Stewart explains, the EEI Master Agreement is a standardized agreement developed by Edison Electric Institute and the National Energy Markets Association. It generally consists of a form agreement, a cover sheet and a confirmation letter. The cover sheet is often used by parties to elect certain options and to modify the terms of the form agreement if so desired. The *Pro Forma* EEI Master Agreement is not filed with the Commission. The Commission has accepted for filing a *Pro Forma* short-form market-based tariff and umbrella service agreement, which is intended to be used in conjunction with the EEI Master Agreement. Exh. S-4 at 5:18-6:4.

Contingent Capacity Purchase and Sales Agreement, which

to take any action which is inconsistent with the just and reasonable nature of the rates:

> CDWR acknowledges and agrees that all payments to [Dynegy] hereunder, . . . are "just and reasonable" within the meaning of Section 451 of the Public Utilities Code and that CDWR shall not take any action or fail to take any action which is inconsistent with the just and reasonable nature of such payments.

Exh. DYN-2 at EOB-DYN-1-0005286. Mr. Lednicky explains that given the statutory scheme and the CDWR funding mechanism established by the emergency California Assembly Bill (AB 1X),[20] Dynegy insisted on this provision, otherwise Dynegy would not have had any assurance of payment and no assurance that CDWR would not later seek to devise a way to abrogate the contract. Exh. DYN-1 at 33:6-9. He also states that Section 8.F was not intended to allow CDWR to seek relief from the Commission to reform or abrogate the contract under Section 206 of the FPA under a just and reasonable standard of review. Exh. DYN-1 at 33:15-34:5. According to Mr. Lednicky:

> It seems clear to me that any argument advanced by, or on behalf of CDWR, that the FERC can or should review and determine whether the Agreement, or
>
> an action "inconsistent
>
> with the just and reasonable
>
> and is expressly prohibited by the Agreement. *Id.*

38. While this Commission's determination regarding whether a rate is just and reasonable is not governed by Section 451 of the Public Utilities Code, this provision does

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[20] Exh. CAL-15.

suggest that the parties agreed that they would not take any action which is inconsistent with the presumed just and reasonable nature of the rates in this contract. Accordingly, and because the contract is otherwise silent with respect to

Stewart explains, the *Mobile-Sierra*
dard should be applied in this instance. Exh. S-4 at 10:15-12:10.

b. *EPME Contract*

39. The EPME contract with CDWR was established pursuant to the EEI Master Agreement and entered into on February 13, 2001. Exh. CAL-34. The contract states that the rates, terms and conditions are provided in accordance with the general terms and conditions under EPME's

evidence was presented regarding whether and to what extent the parties discussed either limiting or preserving their rights to make unilateral changes to the rates, terms or conditions of the contract. Absent specific language to the contrary and considering Commission precedent in favor of protecting the integrity of contracts, Ms. Tingle-Stewart concluded that the *Mobile-Sierra*
applies. Exh. S-4 at 10:1-14.

c. *MSCG Contract*

40. The MSCG contract was also established pursuant to the EEI Master Agreement. It was entered into on February 14, 2001. Exh. MSC-2. The contract is similarly
to make unilateral changes in
the rates, terms or conditions of service. According to Mr.

reserve its right to request unilateral changes to the contract by filing a Section 206 Complaint at FERC." Exh. MSC-1 at 9:16-18. It is not clear why MSCG did not insist on specific language that li
rights to make a change in the rates, given that MSCG in

negotiating with Public Utility District No. 1 Snohomish County, Washington approximately three weeks before insisted on inserting specific language that the rates were not subject to change through a filing pursuant to either sections 205 or 206 of the FPA. Exh. S-4 at 8:7-15. However, given that the contract is silent as to limitations on the teral change, and no evidence was presented that even suggested that the parties discussed this matter much less concluded that the just and reasonable standard should apply when a party seeks to make a change, Ms. Tingle-Stewart concluded that the *Mobile-Sierra* consistent with precedent. Exh. S-4 at 7:17-9:18.

d. *Sempra Contract*

41. The Sempra contract was executed on May 4, 2001. Exh. SER-2. It consists of an Enabling Agreement (which was filed with the Commission),[21] and an accompanying Energy Purchase Agreement (which was not filed with the Commission). The Enabling Agreement is a short, two-page document that refers to the Energy Purchase Agreement for specificity regarding the rates, terms and conditions of service. The only provision which addresses either

the Energy Purchase Agreement. It provides:

> FERC. The Parties acknowledge that (i) this agreement provides for wholesale power sales subject to the jurisdiction of the FERC under the FPA; and (ii) the rates, terms and conditions of this Agreement are thin the meaning of the FPA and that changes in market conditions will not render such rates, terms and conditions "unjust" or

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[21] The Enabling Agreement was filed with the Commission on June 28, 2001 under Sempra's market-based rate schedule in Docket No. ER01-2443-000. The Enabling Agreement was accepted for filing on August 2, 2001.

"unreasonable" for purposes of Section 206 of the FPA. *Id.*

42. As the specific language of the contract reflects, if the only problem with the rates, terms and conditions in the contract is due to changes in market conditions, then there is no basis for either party to complain that the rates, terms and conditions in the contract are no longer just and reasonable. Exh. S-1 at 15:10-14. As explained more fully by Sempra Witness Michael Niggli with regard to the intent of the parties here, initially Sempra proposed contract language that would give both CDWR and Sempra the unilateral right to seek modification. But because of CDWR's negative reaction to the idea that FERC would have the ability to review the rates, terms and conditions of the contract, they agreed to modify the contract to limit the unilateral right of either Sempra or CDWR to modify the rates, terms or conditions of service. Exh. SER-1 at 34:10-26. Based on the specific language in Section 10.03 of Sempra's Energy Purchase Agreement and the testimony of Sempra's witness, Ms. Tingle-Stewart concluded that the *Mobile-Sierra* "public interest" standard applies to this contract as well. Exh. S-4 at 15:14.

43. Based on the specific language of the subject contracts and the evidence of record proffered in this proceeding as discussed *supra*, it is the determination of the undersigned ALJ that the Sellers and Staff have submitted persuasive testimony and probative supporting exhibits demonstrating that the remaining contracts between CDWR and Dynegy, EPME, MSCG and SER are subject to review under the *Mobile-Sierra* "public interest" standard. That evidence demonstrates that the contracting parties did not intend to preserve their rights to make unilateral application to the Commission for changes in rates, terms or conditions of the Indicated Contracts. *See, e.g.*, Exh. SER-1 at 34:10-26 (Niggli); Exh. DYN-1 at 33:10-34:5 (Lednicky).

Rather, the extrinsic evidence of record indicates that the State had very little confidence in the Commission as an avenue for relief at the time these contracts were negotiated, that CDWR negotiated the subject contracts in a

negotiating team focused almost exclusively on the pricing terms of the subject contracts. In fact, at least one witness testified that precluding unilateral application to the Commission for changes in rates, terms and conditions was an issue of importance to CDWR and that the parties agreed to language to this effect in their executed contract. Exh. SER-1 at 34:6-26 (Niggli); Exh. SER-32 at 6:17-28 (Niggli).[22]

44. Somewhat belatedly, after the close of the evidentiary record in this proceeding on December 12, 2002, after the filing of Initial Briefs by the parties and Trial Staff on January 10, 2003, and after issuance of the Commission's January 10 Order,[23] by pleading filed on January 14, 2003,

argued, or submitted evidence, to the effect that the absence of an explicit *Mobile-Sierra* provision in the remaining four contracts is itself a basis for not applying the *Mobile-Sierra* standard to those contracts. Accordingly, to the extent the *Mobile-Sierra* standard applies to the contracts with explicit *Mobile-Sierra* provisions, it applies to

[24] This result is con-

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[22] For example, with regard to the SER Agreement, Michael R. Niggli, President of SER, testified that, at CDWR's insistence, language was inserted into the SER Agreement to ensure that the Commission would not have the ability to review the rates, terms and conditions of the SER Agreement. Exh. SER-1 at 34:10-26 (Niggli).

[23] Commission *Order on Motion for Summary Disposition* issued on January 10, 2003, 102 FERC ¶ 61,025 (January 10).

[24] January 14, 2003, Answer of California Public Utilities Commission and California Electricity Oversight Board to Motion to Hold Briefing in Abeyance.

sistent with the undersigned AL
four contracts and the extrinsic evidence of record as discussed *supra*.

Conclusion

45. A review of each of the four remaining contracts and of the evidentiary record in this proceeding supports a finding that the parties did not retain the right to unilaterally seek changes to their contracts, nor did the parties intend to do so. As here, where the contract has not preserved the rights of a party to seek unilateral modifications, the finding that the *Mobile-Sierra* standard of review applies to a negotiated contract unless the contract expressly states otherwise serves to protect the expectations of the contracting parties that their negotiated agreement will be respected, thus promoting stability of contracts, stability of the market as a whole, and protecting ratepayers by encouraging the utilization of contracts to reduce reliance on the more costly and volatile spot market, while still protecting

tions afforded to consumers under the FPA.[25]

46. While the State continues to assert its position, as set forth in detail in their Complaints, that the *Mobile-Sierra* not applicable to any of the seven contracts challenged in these proceedings because, among other reasons, neither the Complainants nor the consumers they represent are signatories to any of these contracts, Complainants recognize that the Commission has rejected these arguments in its April 25, 2002 Order setting these proceedings for hearing, 99 FERC ¶ 61,087, at pp. 61,382-83, and again in its July 23, 2002

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[25] *Texaco Inc. v. FERC*, 148 F.3d 1091, 1095 (D.C. Cir. 1998). *See also Town of Norwood v. FERC*, 202 F.3d 392, 400 (1st Cir. 2000); *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 953 (D.C. Cir. 1983).

Order on Rehearing 100 FERC ¶ 61,098, at p. 61,397, and that these rulings bind the undersigned ALJ.[26]

47. Specifically, in the April 25 Order, the Commission
sertion that the CPUC and
CEOB do not have authority to
contracts holding that the CPUC
Id. at pp. 61,382-83. In doing so, and permitting the complaints to go forward, the Commission specifically ruled that
the shoes" of CDWR and therefore are bound by the same standard of review as would apply to CDWR:

> Based on the fact that in negotiating and executing the contracts at issue, CDWR represented the State of California, CPUC and CEOB, which are also State
>
> by bringing these complainants. Thus, the same standard of review applies to these complainants as would apply to a similar complaint filed by CDWR.

99 FERC at pp. 61,382-83.

48. Commissioner Massey dissented in part with a sepa-

is not a party to any of the
Mobile-Sierra language
in the contracts. *Id.* at pp. 61,387-88.

49. However, the Commission affirmed its ruling on rehearing in the July 23 Order holding that:

> The Commission is charged with administering the Federal Power Act and in performance of this duty, the Commission views the State of California, CDWR, CPUC, and CEOB as one and the same entity that, in this case, acted as a buyer in the energy markets.

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[26] January 14, 2003, Answer of California Public Utilities Commission and California Electricity Oversight Board to Motion to Hold Briefing in Abeyance.

100 FERC ¶ 61,098 at P 23.

50. Commissioner Massey again dissented in part stating that this Order "maintains the flawed reasoning that a relationship under agency law concepts may be imputed

at p. 61,397.

51. In the January 10 Order, Commissioner Massey

previous dissents with respect to this and related contract cases, the Presiding ALJ should be directed to apply the just and reasonable standard in evaluating these contracts. I do not consider these Complainants to be bound by the *Mobile-Sierra* language included by the contracting par-
[27]

52. Thus, while the Complainants maintain their objec-
s on the applicability of the *Mobile-Sierra* standard to *any* of the contracts at issue, Complainants concede that there is no basis in the record,
s to date in these proceedings, for not applying the *Mobile-Sierra* standard to the Dynegy, El Paso, Morgan Stanley and Sempra contracts to the same extent it applies to the other contracts already before the Commission for determination.

53. Accordingly, the undersigned ALJ hereby finds that
s to date in these proceedings, and subject to
those rulings, the *Mobile-Sierra* standard applies to the Dynegy, El Paso, Morgan Stanley and Sempra contracts to the same extent it applies to the Allegheny, Coral and Mirant contracts; and, in accordance with the Commission's January 10 Order, hereby certifies the record directly to

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[27] Commission's *Order on Motion for Summary Disposition* issued on January 10, 2003, 102 FERC ¶ 61,025 (January 10 Order).

the Commission for its determination of all other issues remaining in dispute in this consolidated proceeding.

SO ORDERED.

APPENDIX E

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[¶ 61,025]

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

v.

SELLERS OF LONG TERM CONTRACTS TO THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

DOCKET NO. EL02-60-003

CALIFORNIA ELECTRICITY OVERSIGHT BOARD

v.

SELLERS OF ENERGY AND CAPACITY UNDER LONG-TERM CONTRACTS WITH THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

DOCKET NO. EL02-62-003

(CONSOLIDATED)

ORDER ON MOTION FOR SUMMARY DISPOSITION

(Issued January 10, 2003)

Before Commissioners: Pat Wood, III, Chairman; William L. Massey, and Nora Mead Brownell.

1. In this order, we grant in part and deny in part Indi- [1] and Morgan Stanley Capital Group, ons for partial summary disposition of the California Public Utilities Commission's

(CEOB) complaints on the issue of the standard of review applicable to long-term bilateral contracts between the California Department of Water Resources (CDWR) and Indicated Respondents and Morgan Stanley. We will, however, expedite resolution of this proceeding by directing the presiding administrative law judge (ALJ) to determine the applicable standard of review for the contracts not containing explicit *Mobile-Sierra* language, and as to the contracts for which the Presiding ALJ finds the applicable standard terest" standard, to certify the record directly to the Commission for consideration of all remaining issues in the case. We also direct that initial and reply briefs on the remaining issues for such contracts be filed directly with the Commission. We believe that this

process in the current proceeding by providing the

decision, while ensuring expeditious resolution of this proceeding.

Background

2. On April 25, 2002, the Commission issued an order[2] addressing two almost identical complaints filed by the CPUC and CEOB (jointly, Complainants) against a group

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[1] Indicated Respondents are comprised of Sempra Energy Resources, El Paso Merchant Energy, L.P., and Dynegy Power Marketing, Inc.

[2] *Pub. Utilities Com'n of the State of California, et al. v. Sellers of Long-Term Contracts to the California Dep't of Water Resource[s]*, 99 FERC ¶ 1,087, *order on reh'g*, 100 FERC ¶ 61,098 (2002) (April 25 Order).

of sellers of energy under long-term bilateral contracts with the CDWR, including Indicated Respondents and Morgan Stanley. The complaints alleged that the prices, terms, and conditions of such contracts are unjust and unreasonable and, to the extent applicable, not in the public interest, and that the respondents obtained the prices, terms, and conditions in the contracts through the exercise of market power, in violation of the Federal Power Act (FPA).[3] The April 25 Order set those complaints for an evidentiary hearing and rejected motions for summary dismissal of the complaints. The Commission held that the Complainants must satisfy the *Mobile-Sierra* public interest standard of review[4] to justify modification of the contracts containing a specific contractual provision which addresses FPA Sections 205 and 206 rights of the parties to these contracts, as well as the Section 206 rights of third parties.

3. As for the contracts that did not contain an explicit *Mobile-Sierra* provision, the Commission concluded that it did not have a sufficient record to summarily address the issue of the applicable standard of review. Accordingly, the Commission set for hearing the issue of whether the Complainants bear the burden of showing that a challenged contract is contrary to the public interest, or whether they bear the burden of showing that a challenged contract is not

gan Stanley's contracts with CDWR did not contain an explicit *Mobile-Sierra* clause and the issue of the standard of review applicable to their contracts was set for hearing.

4. The Commission also limited the scope of the hearing to the issue of whether the dysfunctional California

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[3] 16 U.S.C. §§ 796, *et seq.* (2000).

[4] *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (*Mobile*); *FPC v. Sierra Pacific Power*, 350 U.S. 348 (1956) (*Sierra*); and *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div.*, 358 U.S. 103 (1958).

spot markets adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue is warranted. In addition, the April 25 Order identified evidentiary factors that an ALJ was instructed to consider in resolving this dispute.[5]

5. Subsequently, the Indicated Respondents and Morgan Stanley, as well as other parties, requested rehearing of the April 25 Order. In a July 23, 2002 order, the Commission denied rehearing, in relevant part.[6]

6. Discovery in the hearing phase of this proceeding was completed on November 25, 2002. Cross-examination ended on December 12, 2002. The post-hearing briefs are due on January 10, 2003.

7. On December 17, 2002, the Commission issued an order denying a motion for summary dismissal of the [7] The December 17 Order directed the Presiding ALJ to omit the initial decision as to the contracts containing a *Mobile-Sierra* provision and certify the record directly to the Commission. We also directed that initial and reply briefs concerning these *Mobile-Sierra* contracts be filed directly with the Commission. Additionally, the Presiding ALJ was instructed to proceed with evaluating the record involving the contracts that do not contain *Mobile-Sierra* provisions for the purpose of preparing an initial decision addressing those contracts.

on for Summary Disposition

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[5] *See* April 25 Order at p. 61,384.

[6] *Pub. Utilities Com'n of the State of California, et al. v. Sellers of Long-Term Contracts to the California Dep't of Water Resources*, 100 FERC ¶ 61,098, at p. 61,393 (2002).

[7] *Pub. Utilities Com'n of the State of California, et al. v. Sellers of Long-Term Contracts to the California Dep't of Water Resources*, 101 FERC ¶ 61,293 (2002) (December 17 Order).

8. On December 19, 2002, Indicated Respondents filed a motion requesting summary disposition of the issue of the applicable standard of review. They argue that the Complainants have failed to develop an evidentiary record on which standard of review should apply to the contracts in question. Indicated Respondents assert that the record shows that the parties intended
ply to their contracts. They, therefore, request that the Commission find that the "publi
e Indicated Respondents and allow them to file their post-hearing briefs directly with the Commission.

9. Alternatively, Indicated Respondents request clarification of the December 17 Order. In particular, they request that the Commission clarify that a favorable ruling by the Presiding ALJ on the issue of the applicable standard of review would be sufficient to allow the Indicated Respondents to join the respondents, whose contracts with CDWR contain an explicit *Mobile-Sierra* provision, in filing their initial and reply briefs directly with the Commission on January 10 and January 27, 2003, respectively.

10. In its motion filed on December 26, 2002, Morgan Stanley states that it agrees with the positions taken by the Indicated Respondents and requests the same relief.

11. In their joint answer, CPUC and CEOB oppose the
and also request reconsideration of the December 17 Order. In particular, the Complainants argue that they have been unfairly placed in the position of filing two sets of briefs while proceeding simultaneously against a suddenly bifurcated group of sellers. They also contend that the proceeding cannot be bifurcated based on the presence or absence of express *Mobile-Sierra* clauses, as the Complainants did not seek at hearing to

establish that the absence of such a clause is relevant to determination of the applicable standard of review.

Commission Trial Staff's Answer

12. The Commission Trial Staff supports the Indicated

contracts at issue should be decided together either by the Presiding ALJ or the Commission. In the Commission Trial Staff's opinion, bifurcating the record at this stage of the proceeding will unnecessarily create a need for duplicative and/or conflicting proceedings with the possibility that the Presiding ALJ and the Commission will

whether the dysfunctional spot markets adversely affected the forward market.

Discussion

13. In the April 25 Order, we set the issue of the applicable standard of review for hearing because we needed additional information in order to determine the applicable standard of review for contracts that did not contain explicit *Mobile-Sierra* language. The evidentiary hearing was established to, among other things, interpret the terms of such contracts and ascertain the intent of the parties at the time these contracts were signed. As we have previously observed, contract interpretation is often a complex process, involving the scrutiny of the contract itself, related documents, and at times parol or extrinsic evidence.[8] At this stage of the proceeding, we still prefer to have the benefit of the initial decision on this issue before we make a final determination. Accordingly, we instruct the Presiding ALJ to proceed with determining which standard of review applies to the contracts not containing explicit *Mobile-*

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[8] *See Oglethorpe Power Corporation v. Georgia Power Company*, 69 FERC ¶ 61,208, at p. 61,825 (1994), *order on reh'g*, 72 FERC ¶ 61,065 (1995); *Delmarva Power & Light Company*, 69 FERC ¶ 61,144, at pp. 61,525-26 (1994).

Sierra language. As to the contracts for which the Presiding ALJ finds the applicable standard of review to be the "just and reasonable" standard, the ALJ should then address the question of wheth
standard has been met. As to the contracts for which the Presiding ALJ determines that the applicable standard of

certify the record directly to the Commission. The Commission will then determine wh
standard has been met.

14. Upon the issuance of the initial decision on the issue of the applicable standard of review, as to the contracts for which the Presiding ALJ determines that the applicable

parties will file their initial and reply briefs on the remaining issues directly with the Commission. The parties will also be afforded an opportunity to file briefs on, and opposing, exceptions to the ALJ's determination of the applicable standard of review.

The Commission orders:

tions are hereby granted in part and denied in part for the reasons discussed in the body of this order.

Commissioner Massey dissenting in part with a separate statement attached.

William L. Massey, Commissioner, *dissenting in part:*

position.

First, consistent with my earlier dissent in this matter, I would grant the Complainants' request for reconsideration of the December 17 Order so that the Commission may

issues. Second, as I have said in previous dissents with respect to this and related contract cases, the Presiding ALJ should be directed to apply the just and reasonable standard in evaluating these contracts. I do not consider these Complainants to be bound by the Mobile-Sierra language included by the contracting parties. And finally, I would direct the Presiding ALJ to evaluate the evidence and render an Initial Decision on whether this standard has been met and on other remaining issues.

The reasoning for my position here is fully set out in my dissents with respect to prior orders in this and related proceedings.[1]

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[1] *See* my separate statements to the December 17 and April 25 Orders, and with respect to *Nevada Power Company et al. v. Duke Energy Trading and Marketing, L.L.C., et al.*, 99 FERC ¶ 61,047, at pp. 61,200 to 201 (2002).

APPENDIX F

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

NOS. 03-72511, 03-74757, 04-70712,
03-74617, 03-74208

PUBLIC UTILITY DISTRICT NO. 1 OF
SNOHOMISH COUNTY WASHINGTON,
PETITIONER,

RELIANT ENERGY SERVICES INC.,
INTERVENOR,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

SOUTHERN CALIFORNIA WATER COMPANY,
PETITIONER,

ENRON POWER MARKETING INC.,
INTERVENOR,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

ATTORNEY GENERAL, STATE OF NEVADA,
PETITIONER,

BP ENERGY COMPANY; MIRANT AMERICAS
ENERGY MARKETING, L.P.,
INTERVENORS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

NEVADA POWER COMPANY; SIERRA PACIFIC POWER COMPANY,
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY WASHINGTON,
PETITIONER,

CALPINE ENERGY SERVICES, L.P.; EL PASO MERCHANT ENERGY L.P.; MORGAN STANLEY CAPITAL GROUP, INC.; MIRANT AMERICAS ENERGY MARKETING, LP; BP ENERGY CO.; ALLEGHENY ENERGY SUPPLY CO., LLC; AMERICAN ELECTRIC POWER SERVICE CORPORATION,
INTERVENORS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

Argued and Submitted Dec. 8, 2004
Filed Dec. 19, 2006

On Petition for Review of an Order of the Federal Energy Regulatory Commission. FERC Nos. EL02-26 et al., EL-02-28, EL02-28-004, EL02-26-000.

Before: BROWNING, PREGERSON, and BERZON, Circuit Judges.

BERZON, Circuit Judge:

The energy crisis in 2000-2001 resulted in extreme power shortages and price volatility in California and other western states. This consolidated appeal raises several interrelated issues concerning a series of wholesale energy con-

r companies in California, Nevada, and Washington during the energy crisis. Petitioners, including retail power companies and state agencies,[1] contended before the Federal Energy Regulatory Commission (FERC) that the contracts should be modified, but FERC concluded that they should not be.

ies") now allege that FERC, in so deciding, did not appropriately apply the just and reasonable standard set by section 206(a) of the Federal Power Act (FPA).[2] They allege that FERC erred in applying the

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[1] Petitioners are Public Utility District No. 1 of Snohomish County, Washington (Snohomish); Southern California Water Company (Southern Cal Water); Nevada Power Company (Nevada Power); and Sierra Pacific Power Company (Sierra Pacific); and the Office of the Nevada Attorney General, Bureau of Consumer Protection.

[2] Although the statute was amended slightly in 2005, this opinion exclusively refers to, and quotes from, the 2000 version. Section 206(a) provided:

> Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is *unjust, unreasonable,* unduly discriminatory or preferential, the Commission shall determine the *just and reasonable* rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

Mobile-Sierra [3] to contracts that were (1) not subject to meaningful initial review or approval, and (2) formed during one of the most erratic and bizarre periods of activity for the western energy market.

We hold that FERC erred both in its procedural reliance on *Mobile-Sierra*[4] and in the substantive standard it used in determining that the contracts at issue did not affect the public interest. FERC's reliance on *Mobile-Sierra* was misplaced because its grant of market-based rate authority lacked a mechanism to provide effective, timely relief from unjust and unreasonable rates due to market dysfunction,

excessive energy prices. Although we would remand to FERC solely because its application of *Mobile-Sierra* was therefore procedurally improper, we further hold that the agency's finding that the challenged contracts do not affect the public interest was based on a substantively erroneous mode of analysis. A remand is therefore necessary to allow FERC the opportunity to review these complaints in the first instance in light of these holdings and determine whether the challenged rates meet the statutory standard.

I. The Federal Power Act and Mobile-Sierra

The FPA governs the actions of public utilities, defined as "any person who owns or operates facilities subject to the

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16 U.S.C. § 824e(a) (2000) (emphasis added). Notably, this provision expressly applied to "any . . . *contract*," as well as to rates unilaterally set.

[3] This shorthand takes its name from two Supreme Court cases decided on the same day, *United Gas Pipe Line Co. v. Mobile Gas Service Corp. (Mobile),* 350 U.S. 332, 76 S. Ct. 373, 100 L. Ed. 373 (1956), and *Federal Power Commission v. Sierra Pacific Power Co. (Sierra),* 350 U.S. 348, 76 S. Ct. 368, 100 L. Ed. 388 (1956).

[4] We use the term "*Mobile-Sierra*" throughout this opinion to refer both to the two original Supreme Court cases and to the doctrine derived from them.

jurisdiction of the [Federal Energy Regulatory] Commis-

covers the "transmission of electric energy in interstate commerce and the sale of such energy at wholesale in inter-

Id. § 824(a). This definition encompasses activities carried out by all of the Intervenor-Respondent companies.

The FPA requires FERC to regulate public utilities for the benefit of consumers. *See Pa. Water & Power Co. v.*

, 343 U.S. 414, 418, 72 S. Ct. 843, 96 L. Ed. 1042 (1952) ("A major purpose of the whole [Federal Power] Act is to protect power consumers against excessive

California ex rel. Lockyer v. FERC (Lockyer), 383 F.3d 1006, 1017 (9th Cir. 2004) (describing "protecting

see also Atl.

, 360 U.S. 378, 388, 79 S. Ct. 1246, 3 L. Ed. 2d 1312 (1959) ("The [Natural Gas] Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and

Two FPA provisions, sections 205 and 206, 16 U.S.C.

obligation to regulate rates for the interstate sale and transmission of electricity. Through these provisions, the FPA empowers FERC to regulate wholesale electricity rates but *not* the rates charged directly to consumers by local utilities. *See* 16 U.S.C. § 824(a), (b)(1). The protection the FPA accords consumers is therefore indirect: By assuring that wholesale purveyors of electric power charge fair rates to retailers, the FPA protects against the need to pass excessive rates on to consumers. At the same time, by assuring that wholesale purveyors of electric power receive a fair rate of return, the FPA assures that such sellers have the incentive to continue to produce and supply power.

The First Circuit has aptly described the interaction of sections 205 and 206:

> In regulating electricity rates, the Federal Power Act follows (with variations) a well-developed model: the utility sets the rates in the first instance, 16 U.S.C. § 824d(a), subject to a basic statutory obligation that rates be just and reasonable and not unduly discriminatory or preferential, *id.* §§ 824d(a)-(b). FERC, which inherited the powers of its predecessor (the Federal Power Commission), can investigate a newly filed rate (section 205, *id.* § 824d(e)), or an existing rate (section 206, *id.* § 824e(a)), and, if the rate is inconsistent with the statutory standard, order a change in the rate to make it conform to that standard, *id.* §§ 824d(e), 824e(a)-(b).
>
> vide refunds vary depending on whether the proceeding is one to investigate a new rate filing or an existing rate. For example, in the former case, the burden is on the utility to show that its rate is lawful, 16 U.S.C. § 824d(e), and, in the latter, the burden is on the FERC staff or the customer to show that the rate is unlawful, *id.* § 824e(b). In both circumstances, however, the statutory test of lawfulness is phrased in the same terms.

Boston Edison Co. v. FERC, 233 F.3d 60, 64 (1st Cir. 2000) (footnote omitted). Additionally, when utilities set rates in the first instance, they may do so via privately-negotiated contracts, filed pursuant to section 205(c)-(d), 16 U.S.C. § 824d(c)-(d).[6] Thus, the FPA, by its terms, creates a role

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[6] Section 205(c)-(d), 16 U.S.C. § 824d(c)-(d), provides:

> (c) Schedules
>
> Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may

for privately negotiated wholesale power contracts, bal-

rates, like unilaterally filed ra

Two Supreme Court decisions, announced on the same day in 1956, explain the approach that federal regulators must apply in certain circumstances when reviewing challenges maintaining that contracted rates are too low to be just and reasonable. *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp. (Mobile)*, 350 U.S. 332, 76 S. Ct. 373, 100 L. Ed. 373 (1956);[6]

> designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, *together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.*
>
> (d) Notice required for rate changes
>
> Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or *contract* relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(Emphases added).

[6] *Mobile* related to the Natural Gas Act, and so did not involve a FPA claim. The Supreme Court, however, referred in *Mobile* to "the virtually identical provisions of the Federal Power Act," 350 U.S. at 346, 76 S. Ct. 373, and the doctrine derived from *Mobile* always has been understood to be fully applicable to FPA section 206(a) cases.

Pac. Power Co. (Sierra), 350 U.S. 348, 76 S. Ct. 368, 100 L. Ed. 388 (1956). These decisions explain how, in the context of the energy industry as it existed in 1956, FERC was to

In *Mobile*, a seller agreed to a long-term fixed rate contract with another business, and the agency accepted it for filing under section 205. The Court held that the seller could not unilaterally increase a contracted rate by filing a new rate under section 205(d), reasoning that the statute

Mobile, 350 U.S. at 338, 76 S. Ct. 373, and recognizing the

and distributors, *id.* at 339, 76 S. Ct. 373. The Court emphasized that the public is served by the negotiation and enforcement of private contract
grity of contracts, [the Natural Gas Act] permits the stability of supply arrangements which all agree is essential
Id. at 344, 76 S. Ct. 373.
At the same time, the Court made clear that while
een the parties to be estab-
the Natural Gas Act provided
for "the protection of the public interest . . . by supervision of the individual contracts, which to that end must be filed
Id. at 339, 76 S. Ct. 373.

Sierra took up where *Mobile* left off, echoing the principle that a unilateral filing of a new rate cannot supersede a contract rate, even if the new rate is just and reasonable. *Sierra*, 350 U.S. at 352-53, 76 S. Ct. 368. The Court then extended *Mobile* to section 206 cases, holding that when a
less than a fair return

so low as to adversely affect
Id. at 355, 76 S. Ct. 368 (emphases

added). As the emphasized language indicates, *Sierra* dealt only with whether a challenged contract rate was too low to serve the public interest. It did not deal with a contract rate alleged to be too high. In these low-rate cases, the Court declared, "the purpose of the power given the Commission by § 206(a) is the protection of the public interest, as distinguished from the private interests of the utilities," as "a contract may not be said to be either '*unjust* or '*unreasonable*

Id. (emphasis added).

Sierra thus did not purport to

te. Rather, it gave substance to that standard in circumstances in which the contention is that the seller of energy finds a long-term contract it entered into no longer profitable. Relying on section 201 of

Court held that when a seller seeks to raise rates after a contract has gone into effect,

whether the rate "might impair the financial ability of the public utility to continue its service, cast upon other con-

Id. (internal quotation marks omitted).

Mobile-Sierra, then, stands for the proposition that *in certain circumstances*, a presumption applies that private parties to a wholesale electric power contract have negoti-

period of time, lawful under the FPA throughout that period.[7] That presumption can be rebutted by establishing is, the interests of the consuming public that the FPA protects.[8]

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[7] The parties and some of the cases speak as if two alternative standards for reviewing wholesale electricity rates exist—the statutory "just and reasonable" standard and the *Mobile-Sierra* public interest standard. We do not find this way of viewing the statutory terrain useful. The FPA establishes a single, albeit general, standard for FERC's adjudi-

As we explain in Part II of this opinion, *Mobile* and *Sierra* arose in a regulatory context in which there was an opportunity for traditional cost-based just and reasonable review before the energy contracts at issue became effective. The regulatory regime evolved, however, and FERC shifted its inquiry from the permissible cost-basis of rates

therefore confront here, for the first time, the intersection of *two* *Mobile-Sierra* doctrine, the product of the courts; the other, market-based rate authorization, the product of recent agency policy as they affect the application of the just and reasonable standard. No case that we have found concerns the intersection of these two doctrines.

While the object of the *Mobile-Sierra* doctrine was an individual contract, the market-based rate authorization inquiry applies to an individual seller, with regard to any covered contract for electrical energy it enters into. The former inquiry occurred contemporaneously with a con-
tter inquiry transpires before

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cation of contract challenges like the present one: whether the challenged contract is "just and reasonable." 16 U.S.C. § 824e(a). The question therefore cannot be not whether the *Mobile-Sierra or* the "just and reasonable" standard of review applies. Instead, we understand *Mobile-Sierra* to establish presumptions regarding whether certain electricity contracts meet the statutory standard, and hold that lack of profitability alone is not a basis for deeming a contract unreasonable when the seller has agreed to the rate that proves unprofitable.

[8] As already noted, the specific factors mentioned in *Sierra* as rebutting this presumption apply to cases challenging a contract rate for being too low. *Mobile* and *Sierra* had no occasion to determine what factors must be shown in other situations.

each contract is formed. This dual shift distinguishes the regulatory context here from that present in *Mobile* and *Sierra* in two material respects: (1) the *timing* of the agen-

before contract formation, and (2) the *substance* of that review no longer focuses on the *terms of the contract.* In other words, since *Mobile* and *Sierra* were decided, both the questions that FERC asks in its initial regulatory review of rates and when it asks them have changed.

Although this regulatory evolution does not render *Mobile-Sierra* a dead letter, it reinforces the need to delineate carefully the prerequisites for its application in the present environment. Our principal question is therefore whether the circumstances that trigger the *Mobile-Sierra* presumption are present in this case. As we explain in Part IV of this opinion, we conclude from the context of *Mobile-Sierra* and from later cases that three prerequisites are necessary to establish the *Mobile-Sierra* presumption: (1) the contract by its own terms must not preclude the limited *Mobile-Sierra* review; (2) the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for effective, timely review of the contracted rates; and (3) where, as here, FERC is relying on a market-based rate-setting system to produce just and reasonable rates, this review must permit consideration of all factors relevant to the propriety of

Taken together, the satisfaction of these three conditions justifies a presumption that parties have negotiated a contract that is just and reasonable between them and therefore triggers the *Mobile-Sierra* public interest mode of review, adjusted to account for the circumstance in which it is the buyer rather than the seller that is challenging the existing contract. When the prerequisites have not been met, however, the *Mobile-Sierra* presumption cannot apply, and FERC must find another method of evaluating whether the challenged rates are just and reasonable.

To explain the origins of these *Mobile-Sierra* prerequisites and illuminate the current role of the doctrine, we begin by considering the historical and regulatory context in which *Mobile-Sierra* developed and the changes in that context since those cases were decided. We then turn to the facts and proceedings underlying the current dispute and, finally, to the derivation and application of the *Mobile-Sierra* prerequisites and standards.

II. Evolution of Power Utility Regulation

A. Early Regulation of Utility Monopolies

Congress passed the Federal Power Act in 1920, establishing the statutory framework described above. Ch. 285, 41 Stat. 1063 (1920). This framework emerged from a wider body of state and federal regulation that revolved around the by-then "familiar mandate" that rates in various indus-

FCC, 535 U.S. 467, 477, 122 S. Ct. 1646, 152 L. Ed. 2d 701 (2002).[9] Before Congress had passed many laws regulating national industries, state legislatures created specialized agencies "to set and regulate rates." *Id.* In the electric power industry, this effort began in the first decade of the twentieth century. By 1914, forty-five states had enacted electricity regulation laws. RICHARD F. HIRSH, POWER LOSS: THE ORIGINS OF DEREGULATION AND RESTRUCTURING IN THE AMERICAN ELECTRIC UTILITY SYSTEM 19-26 (1999).

irst substantial foray into rate regulation occurred in 1887, with the passage of the

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[9] *Verizon* concerned the Telecommunications Act of 1996, which is not relevant to the present case. *Verizon* did, however, include a broader historical discussion of utility regulation, *see* 535 U.S. at 477-89, 122 S. Ct. 1646, that directly relates to energy regulation.

Interstate Commerce Act. Ch. 104, 24 Stat. 379 (1887). This statute, primarily concerned with interstate railroad rates, formed "the model for subsequent federal public-utility

Verizon, 535 U.S. at 478, 122 S. Ct. 1646 n. 3. Under the Interstate Commerce Act, railroad carriers would first propose rate schedules,

to the agency, which would accept the tariff so long as it was "just and reasonable." *Id.* at 478, 122 S. Ct. 1646.

The states and Congress applied this structure to the electric power industry on the basis of two widely-shared assumptions:

First, policymakers assumed that public utilities were

would be inefficient for competing utilities to string parallel power lines. Timothy P. Duane,

Learning from the California Energy Crisis, 19 YALE J. ON REG. 471, 476-77 (2002). Also, utilities could benefit from economies of scale, making a monopoly more efficient than a competitive market. *See* HIRSH, *supra*, at 17-18.

Second, these monopolies, like any monopoly, would be tempted to abuse their market power. Moreover, because electricity cannot be stored, it needed to be produced at the same time consumers demanded it. Shortages anywhere on an interconnected electricity grid could threaten the entire system. The factors unique to the electric power industry made it particularly susceptible to abuse of market power: A local utility could withhold power, demand higher rates, and credibly threaten to disrupt a regional or national market. Regulation would keep local utilities in check. Duane, *supra*, at 477-78.

Early state and federal agencies created two categories

charged directly to the public and wholesale rates charged among businesses involved

Verizon, 535

U.S. at 478, 122 S. Ct. 1646. Under the FPA, the federal government regulates only interstate wholesale electric power sales and interstate electric power transmission, leaving to the states the regulation of rates charged to consumers. *See* 16 U.S.C. § 824(a), (b)(1). State and local

tween businesses and the publ

ernment regulated rates "as between businesses." *Verizon*, 535 U.S. at 479, 122 S. Ct. 1646.

As a result of these differences in their regulatory focus, important differences in methodology developed between federal and state energy rate regulation. Knowing that state regulators focused on rates charged directly to the public and following Congress's "acknowledg[ment] that contracts between commercial buyers and sellers could be

id. (citing section 205(d) and *Mobile*, 350 U.S. at 338-39, 76 S. Ct. 373), the Federal Power Commission (FPC) and, later, FERC both bound by *Mobile-Sierra*—became less inclined to step in and alter filed rates charged among businesses in the energy industry. Even if those agencies wanted to change contract rates, courts, applying *Mobile-Sierra*, would generally assume that those rates were just and reasonable and would probably not harm the public interest. The underlying as-

esale markets, the party charging the rate and the party charged were often sophisticated businesses enjoying presumptively equal bargaining power,

Id. The equal market power of those businesses and the role of state regulation of rates charged to consumers allowed the federal government to set a relatively high bar for proving that a wholesale contract was unjust or unreasonable based on impact on the public. Federal agencies, including the FPC and its successor agency FERC, thus saw their "principal regulatory re-

other businesses. *Id.* At the same time, *Sierra*
that federal regulators *should* reform contracts if that was
Sierra, 350 U.S. at 355,
76 S. Ct. 368 (internal quotation mark omitted), confirmed a continuing federal responsibility to review the impact of wholesale contracts on the public, even though the federal government did not directly regulate rates charged to consumers.

In contrast to federal regu
used more on the demand for
the public than on the perils of rate discrimination." *Verizon*, 535 U.S. at 480, 122 S. Ct. 1646. In California, for instance, the Public Utilities Commission ensured that rates charged by the state's three primary utilities Pacific Gas & Electric, Southern California Edison, and San Diego Gas & Electric were just and reasonable to the consuming public. *See* CAL. CONST. art. XII, § 6; Duane, *supra*, at 480.

Within this two-tiered regulatory structure, case law developed an evolving defini
sonable" standard. *See Verizon*, 535 U.S. at 481-89, 122 S. Ct. 1646. After decades-long debates not relevant here, courts and regulators settled on a system that attempted to match rates to the cost to the utility of providing the
of prudently invested capital
used to provide the service." *Id.* at 485, 122 S. Ct. 1646.

centives for utilities to invest in necessary capacity-building by allowing them to charge rates that would provide a fair rate of return on those investments while at the same time "protect[ing] ratepayers from supporting excessive capacity, or abandoned, destroye
Id. at 486, 122 S. Ct. 1646. These competing elements of cost of

service regulation were inten
Id.; *see also Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1510 (D.C. Cir. 1984). As a result, cost of service regulation would, in theory, lead to the same rates that would exist in a properly functioning unregulated market.

B. Federal and State Regulatory Reform

Our description thus far covers the regulatory landscape through the mid-1990s. Beginning then, the electric power industry saw "complementary initiatives by the FERC and
a cost-based rate regulation regime to a market-based regime. Carmen L. Gentile, *The* Mobile-Sierra *Rule: Its Illustrious Past and Uncertain Future*, 21 ENERGY L.J. 353, 373 (2000).

This move toward energy regulation reform was premised on a new set of widely-shared assumptions:

First, cost-based regulation did not effectively check
See Verizon, 535 U.S. at 486, 122 S. Ct. 1646 ("[T]he prudent-investment rule in practice often [was] no match for the capacity of utilities having all the relevant information to ma
Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Order 888-A, 62 Fed. Reg.

supra, at 33-54 (describing how "[u]tility [m]anagers [g]ain[ed] [d]omi-
latory scheme). Also, local utilities would often deny competitors access to their transmission networks, protecting their monopoly status within a geographic area. *See Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 4 (D.C. Cir. 2002).

Second, with technological changes, public power utilities no longer needed to be monopolies. Technological innovations now permitted transmission of power over longer distances, allowing consumers to obtain power from beyond the geographic range of their local utility. *See Transmission Access Policy Study Group v. FERC*, 225 F.3d 667,

reform orders), *New York v. FERC*, 535 U.S. 1, 122 S. Ct. 1012, 152 L. Ed. 2d 47 (2002).

Third, the newly feasible market competition could drive down wholesale prices and measure the cost of service, including the cost of long-term investments, more accurately than did the previous regulatory regime. Competition,

return on capital sufficient to ensure that companies have financial incentives to provide power. *Interstate Natural* , 285 F.3d 18, 31 (D.C. Cir. 2002).

Based on these assumptions, FERC decided in 1996 to fundamentally reform its regula
state wholesale electricity markets. FERC's orders implementing this electrical power reform, Orders 888 and 889, required each utility that operates transmission lines to allow any other utility in the interstate energy market to use its transmission lines on the same terms applicable to the operating utility itself.[10]

Transmission Access, 225 F.3d at 681-82; Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and

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[10] According to FERC, open access is the first of "two central components." Order 888-A, 62 Fed. Reg. at 12,276. The second central component of the 1996 Orders is their mechanism for allowing utilities to recover "stranded costs," that is, costs which they incurred under the previous regulatory regime based upon an expectation of repayment that may not occur in newly competitive markets. *Id.*

Transmitting Utilities, FERC Order No. 888, 61 Fed. Reg. 21,540, 21,541 (May 10, 1996). Taking advantage of the newly available "open access," utilities would, in theory, have both the market incentives and the legal right to compete with each other. This competition would provide retail consumers with the opportunity to purchase power from a wide variety of producers at relatively lower rates. *Transmission Access*, 225 F.3d at 683. A factory in Albany, California, for example, could, in theory, purchase power from a power plant in Albany, New York, no longer limited in its options to whatever the local utility would sell. Local energy utilities, could, rather than producing their own power to sell to the public, choose between various competing producers and then transfer the expected savings from this competition to the public. FERC estimated that, as a result of such competition, consumers would benefit from annual savings of $3.8 billion to $5.4 billion. Order 888-A, 62 Fed. Reg. at 12,276.

1996 "open access" reforms

charge whatever rates the market would bear. "[A]pproximately a decade ago, companies began to file market-based tariffs that did not specify the precise rate to be ch

that they would charge market-based rates. *Lockyer*, 383 F.3d at 1012. FERC would approve those tariffs if the public utility proved that it lacked, or had adequately mitigated, any ability to significantly affect market prices. *La. Energy & Power Auth. v. FERC*, 141 F.3d 364, 365 & n. 1 (D.C. Cir. 1998); *see also Sw. Pub. Serv. Co.*, 72 F.E.R.C. ¶ 61,208, at ¶ 61,966 (1995) (summarizing criteria for approving market-based rate tariffs). Such grants of market-based rate authorization were open-ended. *See, e.g., So. Co. Servs., Inc.*, 87 F.E.R.C. ¶ 61,214, at ¶ 61,847 n. 3.

teria necessary to demonstrate the lack, or adequate mitigation, of market power. When a public utility implemented

generation] capacity" and was thus entitled to market-based rate authority—that is, the ability to charge whatever rates the market would bear—when it sold power over open access transmission grids. *See* Order No. 888, 61 Fed. Reg. at 21,553; *see Lockyer*, 383 F.3d at 1013 (describing FERC's test for granting market-ba
sist[ing] of a finding that the applicant lacks market power (or has taken sufficient steps to mitigate market power)"); *cf.* EDWARD KAHN, ELECTRIC UTILITY PLANNING AND REGULATION 319 (1991) (describing the *lack* of open access as allowing "market power[to] interfere with

FERC thus based its 1996 reform—and, as this case makes clear, much of its subsequent regulation—on the be-

to ensure that no utility could exercise market power when selling wholesale power. *See* Order No. 888, 61 Fed. Reg. at

transmission may reduce or even eliminate generation-
id. at
s this Rule to facilitate
the development of competitive

our case-by-case approach" to granting market-based rate authority. *Id.*
ensuring that sellers seeking market-based rate authority lack, or have sufficiently mitigated, market power *and* that
of monitoring the market in
which [the seller's] sales will take place." *Entergy Servs., Inc.*, 58 F.E.R.C. ¶ 61,234, ¶ 61,753-54 (1992); *see also*

Lockyer, 383 F.3d at 1016 (requiring a market-based re-
rcement mechanisms sufficient
to provide substitute remedies for the obtaining of re-
Transwestern Pipeline Co., 43 F.E.R.C. ¶ 61,240,
at ¶ 61,650 (1988) (requiring a finding that "competition in the relevant markets will operate as a meaningful constraint on the exercise of ma
Entergy approach, FERC also promised to "modify our market rate criteria if and wh
that any such modification wo
entered into pursuant to existing market-based rate au-

Like FERC, California challenged the monopoly power of electric power utilities. California's efforts to foster competition between utility monopolies had begun after the energy crises of the 1970s. *See* Duane, *supra*, at 482-87. Fed-

See Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, §§ 201, 210, 92 Stat. 3117, 3134-35, 3144-47 (codified at 16 U.S.C. §§ 796(17)(C), 824a-3). California pursued these new options particularly aggressively so that, by 1991, California received a third of its energy from producers other than the monopolies held by local utilities. HIRSH, *supra*, at 93. Those producers demonstrated that a utility could efficiently produce power without taking advantage of economies of scale that supposedly made electricity monopolies
forms and market changes, the monopoly status of local utilities and the methodology of state regulation of monopoly utilities was eroding.

California A.B. 1890, passed in 1996, sought to accelerate this breakup of local utility monopolies by requiring them to divest a substantial amount of their electricity generation facilities. Act of Sept. 23, 1996, ch. 854, 1996 Cal. Legis. Serv. 854 (West). Local utilities also were required to sell power generated by remaining facilities to the California Power Exchange Corporation (CalPX), which was to serve as an auction market for wholesale electricity sales. *Lockyer*, 383 F.3d at 1008-09.[11]

C. Shifting Authority to FERC

When combined with federal preemption law, one crucial result of these energy market regulatory reforms has been

jurisdiction from the states to

supra, at 37

wholesale power sales the type of sales at issue in the challenged contracts in this case falling on the federal side of the line. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966, 106 S. Ct. 2349, 90 L. Ed. 2d 943 (1986) (quoting *Fed. Power Comm'n v. S. Cal. Edison Co.*, 376 U.S. 205, 215, 84 S. Ct. 644, 11 L. Ed. 2d 638 (1964)).

wholesale rates is exclusive. *Miss. Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 371, 108 S. Ct. 2428, 101 L. Ed. 2d 322 (1988). Prior to 1996, vertically-integrated state monopolies would charge public consumers rates regulated by state entities and would purchase power from interstate utilities at rates regulated by FERC. The 1996 FERC reforms opened up local monopolies to competition among suppliers in the wholesale power market, resulting in a sharp increase in wholesale power sales sub-

as utilities shopped

among suppliers. *See* Gentile, *supra*, at 373; *Pub. Util. Dist. No. 1 v. Idacorp Inc. (Grays Harbor)*, 379 F.3d 641 (9th Cir. 2004). Additionally, state regulatory reform laws, like California's A.B. 1890, resulted in a less active role for state regulators and a more active one for FERC, as the breakup of vertically integrated utilities created the need for many more wholesale transactions. In California, for

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[11] The details of A.B. 1890 are discussed below.

lating generator or trader behavior to FERC through A.B.
supra, at 507.

The upshot of these federal and state innovations in electricity regulation is that state regulators, despite their continued authority over rates charged directly to consumers, have much less actual authority over those rates than they did when *Mobile* and *Sierra* were decided. Local utilities now obtain power largely through wholesale contracts subject to FERC's exclusive regulation, rather than through self-generated and self-transmitted power. As a result, state regulators ordinarily must set retail rates with the wholesale rates as an established cost factor. FERC recognized this dynamic when issuing its reform orders, noting that customers will obtain more power delivered via

in which the generation and transmission are separately traded rather than provided by an integrated lo

conditions of unbundled retail transmission ... more

Accordingly, while the state and federal regulatory reforms of the 1990s did not end regulation of the electric energy industry, they did begin a new regulatory era. Although state regulators formerly took an extremely active role so as to ensure the just and reasonable retail power rates, FERC has exclusive jurisdiction over the wholesale rates that now drive the electric power market and, as a practical matter, largely determine the rates ultimately charged to the public. These changes profoundly affect this

the *Mobile-Sierra* doctrine reflects both the historical and regulatory purpose of the doctrine *and* contemporary regulatory reality.

With the history of electric rate regulation thus in mind, we now turn to the facts of the particular contracts at issue and then consider whether FERC applied the correct legal standard to review of these challenged contracts.

III. Factual and Procedural Background

A. The Western Energy Crisis of 2000-2001

This is not the first case, and it will not be the last, that requires this court to address the western energy crisis of 2000-2001, the basic facts of which are outlined elsewhere. *See Pac. Gas & Elec. Co. v. FERC*, 464 F.3d 861, 863-66 (9th Cir. 2006); *of Cal. v. FERC*, 462 F.3d 1027, 1035-46 (9th Cir. 2006); *Bonneville Power Admin. v. FERC*, 422 F.3d 908, 911-14 (9th Cir. 2005); *Lockyer*, 383 F.3d at 1008-11; *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 835-36 (9th Cir. 2004), *cert. denied*, 544 U.S. 974, 125 S. Ct. 1836, 161 L. Ed. 2d 724 (2005); *S. Cal. Edison Co. v. Lynch*, 307 F.3d 794, 800-01 (9th Cir. 2002); *Duke Energy Trading & Mktg., L.L.C. v. Davis*, 267 F.3d 1042, 1045-46 (9th Cir. 2001); *Cal. Power Exch. Corp. v. FERC (CalPX)*, 245 F.3d 1110, 1114-19 (9th Cir. 2001); *see also* Duane, *supra*, at 511-24; Michael A. Yuffee, 22 Energy L.J. 65, 65-84 (2001). Accordingly, we summarize here only those facts most relevant to this case.

As noted, in 1996, the California legislature deregulated the power industry in California through passage of A.B. 1890. The bill froze residential and small commercial consumer retail rates[12] and required that the three largest California investor-owned utilities[13] divest most of their electricity generation facilities. *See CalPX*, 245 F.3d at 1114-15. Additionally, the bill created the CalPX, which operated a single-day auction for day-ahead and day-of trading in wholesale electricity, known as the "spot market." *Id.* at 1114.[14]

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[12] The legislature froze rates at a level utilities expected to be far above rates utilities were likely to have to pay, thus allowing them to recoup "stranded costs" as California's energy market shifted to a new regulatory era. See Duane, *supra*, at 501.

In the summer of 1999, CalP market" to facilitate long-term wholesale electricity contracts. *Id.* The California Public Utilities Commission, however, allowed the investor-owned utilities to purchase only a limited amount of electricity from the CalPX forward markets. The great bulk of their load still had to be purchased from the CalPX spot markets. *Id.* at 1115.

In the summer of 2000, there was a dramatic spike in the price of wholesale electricity in the spot markets. *Id.* For nstrained day-ahead price peaked at $1,099/MWh [megawatts/hour] on June 28, 2000 an astounding 15-fold increase over the pre-restruc- *Id.* at 1115 n. 2.

On November 1, 2000, FERC issued an order explaining that, in its view, this dramatic increase was primarily the result of three factors:

First played a major role in the run-up of prices through significantly increased power production costs combined with increased demand due to unusually high temperatures and a scarcity of available generation resources throughout the West and California in

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[13] The three largest investor-owned utilities were San Diego Gas and Electric Company, Southern California Edison, and Pacific Gas and Electric Company (PG & E). *CalPX*, 245 F.3d at 1114.

[14] The term "spot market" refers to deals for energy provided over periods generally not exceeding 24 hours and entered into the day of or day prior to delivery. It contrasts with the term "forward market," in which energy is delivered some time beyond 24 hours after the sale.

San Diego Gas & Elec. Co., 93 F.E.R.C. ¶ 61,121, at ¶ 61,354, 2000 WL 1637060 (2000).

Second unctions in California and the exposure of California consumers to high prices can be traced directly to an over reliance on spot markets." *Id.* ¶ 61,359. The rules requiring investor-owned utilities to purchase primarily through the spot markets precluded any significant reliance on forwar suppliers who would have been free to implement appropriate risk management strategies could not be induced to rket because the low retail rate, frozen at 10 percent below historical levels, thwarted competitive opportunities for new participants to enter the *Id.*

Third, FERC suggested that there was the opportunity for abuse of the markets through the exercise of market power, but could not point to specific instances. *Id.* ¶ 61,376. FERC's staff later issued a report concluding that the spot market was dysfunctional, partially due to market manipulation by sellers; that conclusion is assumed by all parties here. *See* STAFF OF THE FEDERAL ENERGY REGULATORY COMMISSION, FINAL REPORT ON PRICE MANIPULATION IN WESTERN MARKETS: FACT-FINDING INVESTIGATION OF POTENTIAL MANIPULATION OF ELECTRIC AND NATURAL *available* at www.ferc.gov/legal/maj-ord-reg/lan

California is part of a single integrated electricity market in the West. Its energy problems therefore created a th in California and the *See San Diego Gas & Elec. Co. (June 19 Order)*, 95 F.E.R.C. ¶ 61,418, at ¶ 62,556, 2001 WL 1910052 (June 19, 2001). For example, in the Pacific Northwest, prices have historically averaged approximately $24/MWh. During this period, short term prices spiked to unprecedented levels, peaking at $3,300/MWh in early December of 2000, and during the summer and fall of 2000 averaged between $200/MWh and $500/MWh. Markets were also marked by unprecedented levels of price volatility. In response to this volatility, between August 2000 and December 19, 2001, FERC issued nearly 75 orders providing for spot market mitigation measures, *see, e.g., id.*, most aimed at reducing the size of the spot market. *San Diego Gas & Elec. Co.*, 97 F.E.R.C. ¶ 61,275, at ¶ 62,171 (Dec. 19, [ ]2001).

The order issued on December 15, 2000, is of particular relevance to the issues here. *See San Diego Gas & Elec. Co. (December 15 Order)*, 93 F.E.R.C. ¶ 61,294, 2000 WL 1840337 (Dec. 15, 2000). That order strongly urged investor-owned utilities to move to long-term contracts of two years or more. *Id.*
potentially unjust and unreasonable rates in the long-term
onitor prices in those mar-

addressing any complaints
regarding the pricing of long-term contracts negotiated
Id. ¶ 61,994-95. In response to the contention that such a shift would only transform the forward market into another strong sellers' market resembling the then-dysfunctional spot market, FERC declared
monitoring the possible exercise
of market power" in the forward market. *Id.* ¶ 61,994.

vide customers protection by providing early review of asbid prices that may not be just and reasonable and prompt
Id. ¶ 61,997.

B. Contracts at Issue Here

This consolidated appeal involves three separate sets of contracts, all of which were made pursuant to the Western Systems Power Pool Agreement (Power Pool Agreement), an umbrella agreement that established standardized terms for wholesale energy transactions. All the utilities involved in this case are signatories to that agreement.

1. *Snohomish*

In response to the extreme spike of spot market prices (reaching as high as $3,300/MWh) during December 2000, Snohomish, a public utility for Snohomish County in Washington, determined that it was no longer viable to rely on the spot markets. On December 22, 2000, Snohomish issued a request for proposals to 17 power suppliers, seeking bids for one-to-three year contracts, providing a total of approximately 75-100 megawatts of electricity for 2001.

Snohomish received five bids, but two were unresponsive three responsive bids, no supplier would offer more than 25 MW, so Snohomish accepted all three bids and negotiated contracts with each supplier.[15] That year, Snohomish's Board of Commissioners had previously approved an unprecedented thirty-five percent increase in retail rates, allowing for an average contract price of $125/MWh. Unfortunately, none of the three offers would allow Snohomish to meet this price, and Snohomish chose not to ask its ratepayers for another double-digit rate increase in the same year.

Consequently, Snohomish asked Morgan Stanley an electrical energy commodities dealer what term would be necessary to secure a $100/MWh price for its contract; Morgan Stanley demanded a ten-year term. The parties ultimately agreed to a nine-year term at $105/MWh. Additionally, Morgan Stanley required Snohomish to accept credit terms articulated in a contractual provision termed [16]

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[15] One of the three contracts, signed with Enron Corporation, was terminated in November 2001, as Enron's credit deteriorated. Snohomish sought reform of the other contract, with American Electric Power, and the parties settled that case. The remaining contract, here at issue, is with Morgan Stanley Capital Group ("Morgan Stanley").

Snohomish claims that it suffered losses between January 2001 and March 2002 in excess of $25.7 million and that those losses will escalate over the term of the contract as market rates remain close to traditional levels. FERC specifically found that the Morgan Stanley contracts accounted for an eight percent increase for retail ratepayers over 2001 rates, and other contracts accounted for a fifty-one percent increase. *Nev. Power Co. (November 10 Order)*, 105 F.E.R.C. ¶ 61,185, at ¶ 61,986, 2003 WL 22628184 (Nov. 10, 2003). Snohomish here challenges the term of the contract and the imposition of the Collateral Annex.

2. *Southern Cal Water*

Southern Cal Water owns and operates an electric utility distribution system that serves approximately 21,600 customers in San Bernadino County, California. Southern Cal Water purchases, subject to regulation by the California Public Utilities Commission, an average electric load of about 16.3 MW.

The A.B. 1890 requirements that investor-owned utilities purchase in the spot market did not apply to Southern Cal Water, which owned no transmission lines and generated no electricity. To avoid relying entirely on the spot markets, which it viewed as significantly risky, Southern Cal Water executed a one-year contract with Illinova in April 1999, providing for purchase of 12 MW of uninterruptible around-the-clock energy at a price of $28/MWh. One year later, Southern Cal Water renewed the contract with Dynegy

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[16] Among other requirements, the "Collateral Annex" required Snohomish to post, on two days notice, specified collateral. This requirement has required Snohomish to post as much as $101 million in collateral.

2001, for the same load, at the increased price of $35.50/MWh.

California enacted A.B. 1 on February 1, 2001, allowing the California Department of Water Resources to purchase energy for the then-collapsing large investor-owned utilities and power suppliers. *See* Act of Feb. 1, 2001, 2001 Cal. Legis. Serv. 1st Ex. Sess. 4 (West). At that point, Dynegy informed Southern Cal Water that it was not interested in renewing its contract with Southern Cal Water, because it could sell its entire generation output to the State of California. With the present contract expiring at the end of April 2001, Southern Cal Water engaged in a hurried bidding process.[17]

On March 7, 2001, Southern Cal Water issued a request for proposals for 15 MW of power to six power companies operating in California and requested bids by March 14, 2001. The company requested bids of one to seven years, without specifying a preferred or maximum price. The three bids submitted ranged from $194.50/MWh for a one-year contract to $84/MWh for a seven-year contract. After receiving firm offers at higher prices, Southern Cal Water accepted Mirant's offer of $95/MWh for five years, as the offer that best balanced price against contract length. In light of this increase in Southern Cal Water's wholesale electricity costs, the California Public Utilities Commission allowed the company to recover a portion of the costs of the contract, resulting in a weighted average retail rate of $77/MWh.

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[17] Noting that, in October 2000, Southern Cal Water rejected an offer by Dynegy to extend its contract on a "blend and extend" basis of between $46.50/MWh to $54.50/MWh depending on the length of the proposed contract, *Order on Rehearing*, 105 F.E.R.C. at ¶ 61,988 (internal quotation marks omitted), FERC found that Southern Cal Water *chose* to wait until March 2001 to solicit bids. This statement is misleading. Southern Cal Water could only have become aware that Dynegy would not renew its contract on any terms because of the disincentive to doing so created by A.B. 1 after that law was passed, which was in February of 2001. As noted above, it was Dynegy's pullout that induced Southern Cal Water's frenzied bidding process.

Southern Cal Water maintains that its ratepayers have seen an overall thirty-eight percent increase in their electric bills. FERC found that there was no rate increase for residents, and that the other group of Southern Cal Water ratepayers, those with second homes in certain areas, paid an average monthly electric bill of only $35.13. *Order on Rehearing*, 105 F.E.R.C. at ¶ 61,986.

3. *Nevada Power Companies: Nevada Power and Sierra Pacific*

The challenge brought by Nevada Power and Sierra Pacific seeks to modify over two hundred forward market contracts with various energy sellers for supply of 25-100 MW blocks of power.[18] These contracts range in price from $33/MWh to $290/MWh, and were entered into in 2000-2001 with ten energy companies. FERC found that these contracts were standard products arranged through independent third-party brokers, and concluded that Nevada Power and Sierra Pacific were price-takers, meaning that those utilities took the price the market yielded rather than bargaining or demanding a certain price. *Nev. Power Co. (June 26 Order)*, 103 F.E.R.C. ¶ 61,353, at ¶ 62,398, 2003 WL 21485862 (June 26, 2003). According to FERC, the Nevada companies did not pursue purchase of a diverse mix of products and therefore failed to hedge the risk that spot market prices might fall. *Id.*

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[18] The Nevada companies recently settled their disputes with Morgan Stanley, El Paso Merchant Energy, and Enron Power Marketing. These settlements have no bearing on the legal issues we address.

FERC also found that the Nevada companies pursued an aggressive procurement strategy, purchasing more power than necessary to serve the expected load of their local customers. *Id.* FERC suggests that the Nevada companies were trying to buy as much power as they could before sellers discovered their precarious financial situation. *Id.*

FERC found that if these contracts are not modified, the resulting increase to ratepayers would be no more than five percent. *Id.* ¶ 62,397. The Nevada companies recognize that the retail rates have decreased since they agreed to the challenged contracts, but they maintain that Nevada customers will still pay significantly more than they would pay if the contracts were modified to reflect just and reasonable rates. *Order on Rehearing*, 105 F.E.R.C. at ¶ 61,986. Nevada Power and Sierra Pacific therefore seek to modify their contracts with the energy sellers. *Nev. Power Co. (April 11 Order)*, 99 F.E.R.C. ¶ 61,047, at ¶ 61,185, 2002 WL 32126219 (Apr. 11, 2002). Nevada Power is seeking relief for contracts that had not yet gone to delivery at the refund effective dates set by FERC (between late January and April of 2002, depending on docket number).[19] *Id.* ¶¶ 61,185, 61,192.

C. Agency Proceedings

The agency actions challenged here arise from a series of orders issued by FERC with regard to the complaints filed by the local utilities.

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[19] Upon setting a section 206 complaint for hearing, FERC establishes a "refund effective date," which is a date establishing the period from which complainants may attain relief should the proceedings extend beyond that established date. In other words, if a party makes a complaint on January 1, 2004, but FERC does not set the complaint for hearing until July 1, 2004, FERC may establish a "refund effective date" of March 1, 2004, so that the complainant will not suffer from the agency's delay or from continued agency proceedings.

1. *Order Setting the Local Utilities' Complaints for Hearing (April 11 Order)*

On April 11, 2002, pursuant to section 206 of the FPA, FERC set a hearing concerning during the time period from November 1, 2000 through June 20, 2001, and that have not yet concluded," because

transactions that conclude prior to the refund effective *Id.* ¶ 61,191 (footnote omitted). FERC also set refund effective dates for each of the complaints. *Id.* ¶ 61,192.

FERC explained in its April 2002 order that it did not have enough information yet to address the *Mobile-Sierra* issues definitively. The agency one of the contracts identified by the complainants, Section 6.1 of the umbrella [Power Pool] agreement appears to be the only specific contractual provision which may affect *Id.* § 61,190. The remaining contract, between PUD and Morgan Stanley, has a separate provision addressing both FPA sections 205 and 206. *Id.* ¶ 61,190 & n. 11. FERC also noted a key dispute between the parties: had an adverse effect on the long-term, bilateral markets in California, Nevada *Id.* ¶ 61,191. The hearing, designed to illuminate these questions, was to ad- nal California spot markets adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue *Id.* (footnote omitted). FERC specifically excluded "issues concerning the Commission's policies on granting market-based rate authority or on regulation of *Id.*

2. *Initial Decision of the Administrative Law Judge (Initial Decision)*

On December 19, 2002, after an extensive hearing, Administrative Law Judge Carmen Cintron issued a lengthy initial decision on the complaints. *Nev. Power Co.*, 101 F.E.R.C. ¶ 63,031, 2002 WL 31889939 (Dec. 19, 2002). She ultimately concluded that (1) the *Mobile-Sierra*

id.

¶ 65,277, and (2) the complainants failed to demonstrate that the spot market sufficiently adversely affected the forward market to merit revision of the contracts under the *Mobile-Sierra* doctrine, *id.* ¶ 65,295.

3. *Order on Initial Decision*

On June 26, 2003, FERC issued a lengthy opinion in which it affirmed the Initial Decision. *Order on Initial Decision*, 103 F.E.R.C. at ¶ 62,400.

included: (1) Section 6.1 of the Power Pool agreement's express reservation of joint modification under section 205 of the FPA impliedly waived the right to seek unilateral modification, *id.* ¶ 62,388; (2) this waiver meant that review was limited to the *Mobile-Sierra*

id. ¶¶ 62,388-89; (3) applying the three factors articulated in

Sierra

complainants failed to meet th

because "[t]he fact that a contract becomes uneconomic

id. ¶ 62,384; and (4) the totality of the circumstances evidence analyzed by the ALJ further demonstrated that "the challenged transactions were the result of [the local utili-

unfairness, bad faith, or duress

id. ¶ 62,399-62,400. Because modification was therefore not warranted, FERC denied the complaints. *Id.* ¶ 62,400.

Although FERC acknowledged that it had set the ALJ hearing in large part to decide "whether the dysfunctional California ISO and PX spot markets adversely affected

id. ¶ 62,385, FERC

concluded that evidence showing the spot market's effect on

at reviewed in the Staff

Report[20]

able' standard of review."
Id. ¶ 62,397. FERC further explained, applying the *Mobile-Sierra*

modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms, and conditions are contra
showing the local utilities failed to make. *Id.*

Commissioner Massey issued a vigorous dissent, disagreeing with all of the Co

the Federal Power Act is to ensure that prices are just and
Id. ¶ 62,403
Furthermore, even under a "public interest" standard, which he maintained was not applicable to these contracts, Commissioner Massey determined there was

> simply no persuasive public interest rationale for protecting and sanctifying contracts negotiated in this unprecedented and extraordinary environment. . . . It would simply defy logic to conclude that the high prices in these contracts were not adversely influenced by market conditions that included the exercise of market power and widespread market manipulation.

Id. ¶ 62,408.

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[20] FERC at first stated that it "t[ook] into consideration the findings of the Staff Report," *Order on Initial Decision*, 103 F.E.R.C. at ¶ 62,396, but later stated its conclusion that those findings were not "relevant" under *Mobile-Sierra*, the standard FERC determined appropriate. *Id.* ¶ 62,397.

4. *Order on Requests for Rehearing and Clarification*

Complainants applied for rehearing. On November 10, 2003, FERC reaffirmed its previous holdings. *Order on Rehearing*, 105 F.E.R.C. at ¶ 61,980. FERC, however, revised its previous factual findings to recognize that the customers of Snohomish and Southern Cal Water did experience a retail rate increase. FERC concluded, however, that these increases either were not significant or were not pertinent, because the local utilities did not prove the cause of the increases. *Id.* ¶¶ 61,986-87. FERC also rejected peti-

the Commissioners violated procedural requirements and the Sunshine Act by engaging in ex parte communications. *Id.* ¶¶ 61,991-94. The local utilities then filed this petition

not in accordance with law." 5 U.S.C. § 706(2)(A). We review de novo the question whether FERC complied with and understood its statutory mandate. *City of Fremont v. FERC*, 336 F.3d 910, 914 (9th Cir. 2003); *Am. Rivers v. FERC*

ons of the statutory provi-

issues of statutory construction and must reject administrative constructions which are contrary to clear congres-

Am. Rivers, 201 F.3d at 1194 (quoting

, 113

F.3d 1121, 1124 (9th Cir. 1999)). FERC's factual findings are conclusive so long as they

l (b).

IV. Prerequisites To Applying *Mobile-Sierra*

As explained above, there is but one statutory standard addressing the lawfulness of wholesale electricity rates. That standard requires that *all* otherwise,[21] we are convinced that *Mobile-Sierra* establishes one means of review under the just and reasonable standard, applicable in certain limited circumstances. The statute will admit of no other conclusion, and the Supreme Court case law supports it.

Sierra framed its analysis as a determination as to

precedent" to a section 206 remedy, a "finding that the

g that the established rate was invalid *not* because it applied the usual section 206(a)

holds that the contract rate is unreasonable solely because it yields less than a fair return

Id. at 354-55, 76 S. Ct. 368. As the *Sierra* Court explained,

> [W]hile it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain. . . . [T]he purpose of the power given the Commission by § 206(a) is the protection of the public interest, as distinguished from the private interests of the utilities. . . . When § 206(a) is read in the light of this purpose, it is clear that a contract may not be said
>
> it is unprofitable to the public utility.

Id. at 355, 76 S. Ct. 368. *Sierra*, then, simply held that differ in the context of an established bilateral contract, not that the statutory standards no longer govern. The Supreme Court confirmed this understanding in *Verizon,*

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[21] *Boston Edison Co.*, 233 F.3d at 65, for example, refers to *Mobile-Sierra* as establishing a "public interest standard," separate from the statutory just and reasonable requirement, and referring to that standard as having been "created out of whole cloth."

the rate and the party charged were often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a 'just and reasonable' 535 U.S. at 479, 122 S. Ct. 1646.

Beginning with that understanding of *Mobile-Sierra,* we turn to the limited circumstances in which its presumption applies. Although no case has outlined these conditions succinctly, we derive three prerequisites from the context of *Mobile-Sierra* and from later cases employing the doctrine.

A. Contractual Waiver

As an initial matter, the contested contract by its own terms must not preclude the limited *Mobile-Sierra* mode of review. *See Texaco Inc. v. FERC (Texaco II),* 148 F.3d 1091, 1096 (D.C. Cir. 1998); *Ne. Utils. Serv. Co. v. FERC (Ne.Utils.I),* 993 F.2d 937, 960 (1st Cir. 1993). *Mobile-Sierra* presumes that private parties have negotiated an agreement that they view as just and reasonable over the time period covered. If, by the very terms of their agreement, the parties indicate otherwise, FERC cannot assume the mutual satisfaction of the parties.

For example, parties can include in a contract an express reservation of a right to make changes unilaterally, known *Memphis* *See United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.,* 358 U.S. 103, 105, 112, 79 S. Ct. 194, 3 L. Ed. 2d 153 (1958). Such a clause will preclude application of the *Mobile-Sierra* presumption. The rationale for enforcing such clauses is that if the contract does not settle rates as between the parties for the term of the agreement or call for limited, *Mobile-Sierra* review, then application of *Mobile-Sierra* does not stabilize or protect the sanctity of contract. *See id.* at 112, 79 S. Ct. 194 (noting that the "decisive difference" between *Memphis* and *Mobile* *Mobile* one party to a contract was asserting that the Natural Gas Act somehow gave it the right unilaterally to abrogate its contractual undertaking, whereas here petitioner seeks simply to assert, in accordance with the procedures specified by the Act, rights *expressly reserved*

other words, *Mobile-Sierra* serves to protect contracts from unilateral change, but that purpose is not served when the parties expressly have permitted such change.

B. Regulatory Context

Even if it is established that the parties contracted with the intent that *Mobile-Sierra* apply, a further barrier remains: The regulatory context in which the contracts were initially formed must provide a sound basis to believe that the resulting rates are just and reasonable. Absent

liance on the presumption would amount to a complete abdication of its statutory responsibility under the FPA. As the following sub-sections explain, two related conditions operate to ensure that a foundation for the presumption exists: (1) timely and procedurally effective review of rates which in the contemporary regulatory regime can be limited to review of a

and (2) meaningful substantive standards for review of the circumstances of contract formation.

1. *Timely and Effective Review of Rates*

To justify the *Mobile-Sierra* mode of review, the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for initial review of the contracted rate. In *Mobile* and *Sierra*, for example, the rates had been submitted to the agency previously under section 205 and allowed to remain in effect. *See Mobile*, 350 U.S. at 336, 76 S. Ct. 373; *Sierra*, 350 U.S. at 352, 76 S. Ct.

368. Such an initial review is an important precondition to *Mobile-Sierra* because, as FERC has explained, applying the doctrine in "first review

the public interest would be negligible and public regulation would consist of little more

Potomac Elec. Power Co. v. FERC (PEPCO), 210 F.3d 403, 409 (D.C. Cir. 2000) (quoting *Ne. Utils. Serv. Co.*, 66 F.E.R.C. ¶ 61,332, at ¶ 62,087, 1994 WL 92839 (1994), , 55 F.3d 686 (1st Cir. 1995)); *see also PEPCO*, 210 F.3d at 406 (noting that

een found to be just and reasonable when originally approved" by FERC).

Consistent with its previous rulings, FERC concedes here that an opportunity for initial review of whether a rate is just and reasonable is necessary for *Mobile-Sierra* to apply. The Intervenor-Respondents, however, cite to a thirty-year old D.C. Circuit decision, *see Borough of*

, 494 F.2d 1104, 1112-14 (D.C. Cir. 1974), and argue that an opportunity for initial review is *not* necessary to trigger the *Mobile-Sierra* presumption. We disagree.

The analysis in *Lansdale* is not applicable to this case. In *Lansdale*, a seller, joined by the Commission, sought to ignore a rate in a contract to which it had previously agreed but which it had not properly filed with the Commission, and instead file a higher rate,

Id. at 1112; *see also id.* at 1107-08. The D.C. Circuit refused to allow this unilateral revision of an agreement, holding that the Commission could not permit the higher rate of the second contract to go into effect unless and until it found that the original rates were unlawful. *See id.* at 1117.

Lansdale

tory duty to file into a vehicle for breaching the 1971 con-

Id. at 1112. In other words, *Lansdale* focused on whether *Mobile-Sierra* review allows the adoption of a *second* contract with a higher rate when the first was never correctly filed with the Commission. As such, *Lansdale*

of the rate-filing requirement. *Lansdale* did *not* decide, because the question was not before it, that the *Mobile-Sierra* presumption always applies to the filing of an initial rate, regardless of the circumstances.

In this case, the answers to the questions presented turn in part upon whether *Mobile-Sierra* applies to the rate *first* set in a contract entered into under a seller's market-based rate authority, rather than only to a later challenge maintaining that earlier-established rates are *no longer* just and reasonable. The local utilities do not maintain that the original contract is void because it was never filed, but rather that the rates set were unjust and unreasonable when established and should be modified.

position that a seller may not profit by failing properly to file a rate-setting contract it freely entered into is hardly remarkable, but is also not particularly pertinent to the questions at issue here.

Indeed, just a year before *Lansdale* was decided, the Supreme Court recognized the importance of an opportunity for an initial just and reasonableness review to the overall statutory scheme. In *Federal Power Commission v. Texaco, Inc. (Texaco I)*, 417 U.S. 380, 94 S. Ct. 2315, 41 L. Ed. 2d 141 (1974), the Court struck down an indirect regulatory scheme adopted by the Commission that would have

See id. at 382, 395, 94 S. Ct. 2315. One of the primary reasons for the decision was that

these contemplated increased rates for flowing gas would be just and reasonable. The Commission merely asserts in its brief here that it was familiar with the existing contracts and must have considered the rates reserved to be acceptable under the *Id.* at 396, 94 S. Ct. 2315.

In short, FERC is correct to recognize that the *Mobile-Sierra* doctrine [applies] only if a newly-entered contract remains in effect *after* there is an opportunity for plenary,

2. *Meaningful Review of the Circumstances of Contract Formation*

Not only must FERC have an opportunity for some initial review of rates, but the scope of that review must permit consideration of the factors relevant to the propriety *See Atl. City Elec. Co.*, 295 F.3d at 14 (holding that *Mobile-Sierra* there was no reason to question what transpired at the contract formation stage") (citing *Town of Norwood v. FERC*, 587 F.2d 1306, 1312 (D.C. Cir. 1978)). The original premise of *Mobile-Sierra* was that as long as the rate was just and reasonable when the contract was formed, there would be a presumption based on both the need to protect stability of contract and the likelihood that market participants entering into long-term contracts can protect their own interests that the reasonableness continued throughout the term of the contract. *See Verizon*, 535 U.S. at 479,

the rate and the party charged were often sophisticated businesses enjoying presumptively equal bargaining power,

rate as between the two of them."). In the present regulatory regime, these relevant factors focus on whether the original negotiations occurred in a functional marketplace such that we may presume the contracted rates were originally just and reasonable.

V. Application of *Mobile-Sierra*

A. Contractual Waiver of Section 206 Rights

Having established the prerequisites to *Mobile-Sierra* review under the current regulatory regime, we address first whether the contracts at issue permit *Mobile-Sierra* review. In this case, FERC determined that there was no express reservation of unilateral modification. As FERC

complainants, Section 6.1 of the umbrella [Power Pool] Agreement appears to be the only specific contractual

to contracts entered into under the [Power Pool] agree-
April 11 Order, 99 F.E.R.C. at ¶ 61,190.[22]

The relevant portion of section 6.1 states:

> Nothing contained herein shall be construed as affecting in any way the right of the Parties to jointly make application to FERC for a change in the rates and charges, classification, service, terms, or conditions affecting [Power Pool] transactions under Section 205 of the Federal Power Act and pursuant to FERC rules and regulations promulgated thereunder.

Id. ¶ 61,190 n. 10. Applying the interpretive doctrine of *expressio unius est exclusio alterius*,[23] FERC viewed the reservation of *joint* section 205 rights as confirming the

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[22] FERC found that Section 39B of the Snohomish-Morgan Stanley Confirmation Agreement expressly restricts the parties' rights to amend under both FPA sections 205 and 206. *April 11 Order*, 99 F.E.R.C. at ¶ 61,190 & n. 11. FERC noted, however, that even if Snohomish could overcome the restriction in Section 39B, it would still be restricted by Section 6.1 of the Power Pool agreement. *Order on Initial Decision*, 103 F.E.R.C. at ¶ 62,389. Because we hold the Power Pool agreement, both standing alone and taking Section 6.1 into account, is consistent with *Mobile-Sierra* review, we have no need to consider Section 39B of the Snohomish-Morgan Stanley Confirmation Agreement.

[23] The Latin phrase means the "express[ion] or inclu[sion of] one thing implies the exclusion of the other." BLACK'S LAW DICTIONARY 620 (8th ed. 1999).

terms for the time period covered. *Order on Initial Decision*, 103 F.E.R.C. at ¶ 62,388.

deference in construing contracts where the sales are subject to FERC regulation." *Boston Edison*, 233 F.3d at 66 (citing *Memphis*, 358 U.S. at 114, 79 S. Ct. 194); *see also City of Seattle v. FERC*, 923 F.2d 713, 716 (9th Cir. 1991) (granting FERC deference in the interpretation of contracts). With or without that deference, we agree with FERC that these contracts do not preclude *Mobile-Sierra* review, but we do not rely on the *expressio unius* precept in so concluding. Instead, like the D.C. Circuit in *Texaco II*, 148 F.3d at 1096, we hold that private long-term contracts can be *generally* governed by *Mobile-Sierra* if such review is otherwise appropriate, unless there is a specific indication in the contract that section 205 or 206 rights have been reserved.

Texaco II considered a boilerplate clause that said that

all applicable laws, statutes, ordinances, safety codes and rules and regulations of gov-

Id. The D.C. Circuit held that such a general clause does not reserve compliance with section 206 standards. In so deciding, the D.C. Circuit stated, in essence, a default rule, explaining: "The law is quite clear: absent contractual language 'susceptible to the construction that the rate may be altered

Mobile-Sierra doctrine applies." *Id.* (alterations in original) (quoting *Appalachian*

, 529 F.2d 342, 348 (D.C. Cir. 1976)). After *Texaco II*, the prevailing rule of contract interpretation with regard to the preservation of limited *Mobile-Sierra* review, according to the First Circuit, is that

otherwise

do not "negate the ordinary, default rule that *Mobile-Sierra*

Boston Edison, 233 F.3d at 67 (citing *Texaco II*, 148 F.3d at 1096).

The trio of authorities cited by the local utilities, all from the D.C. Circuit and all pre-*Texaco II*, are not inconsistent with this interpretive principle. *See Union Pac. Fuels, Inc. v. FERC*, 129 F.3d 157 (D.C. Cir. 1997); *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950 (D.C. Cir. 1983); *Kansas Cities v. FERC*, 723 F.2d 82 (D.C. Cir. 1983). In two of these cases, the court inferred an intent to permit full FERC review from a provision restricting review in narrow circumstances. *See Papago*, 723 F.2d at 954; *Kansas Cities*, 723 F.2d at 86-90. To infer from a narrow restriction on *unilateral* changes an intent otherwise to allow such changes, as *Kansas Cities* and *Papago* permitted, is quite different from inferring from a narrow authorization of *joint* authority to make changes an intent to allow *unilateral* changes, as the local utilities here insist FERC was required to do.

By contrast with *Papago*, *Kansas Cities*, and this case, the disputed contracts in *Union Pacific Fuels* did include a *Memphis* clause. *See Union Pac. Fuels*, 129 F.3d at 161. The contracts, however, also included a clause restricting the ability of the parties to s

Id. (internal quotation mark omitted). In these unusual circumstances, the D.C. Circuit

changes to its rate structure under section 5 of the Natural Gas Act despite that narrow restriction and noted:

> Nothing in the contracts expressly exempted the private agreement from rate changes initiated by FERC under NGA § 5. . . . While Petitioners protest that boilerplate language acknowledging rate changes by FERC should not render [the] *Mobile-Sierra* doctrine inapplicable, . . . they do not explain why they

> could not have adopted language that would simply and clearly have invoked *Mobile-Sierra.*

Id. at 161-62. *Texaco II*, issued by the same court a year later, explained that this language in *Union Pacific Fuels* does not have application beyond the situation there presented, in which the contract contains a clause that does, generally, negate the default *Mobile-Sierra* rule. *See Texaco II*, 148 F.3d at 1096 (noting that in *Union Pacific Fuels* *inadvertently* lent support to the in- *invoking Mobile-Sierra*, FERC ordinarily is free to review rates without regard to the *Mobile-Sierra* presumption (emphasis added)).

We agree with the D.C. and First Circuits that the *Mobile-Sierra* presumptions are, in essence, self-executing. Adoption of a *Memphis* clause permitting a party to an energy contract to modify its terms unilaterally demonstrates that the parties were not seeking to establish the stability of energy contracts the *Mobile-Sierra* doctrine seeks to foster. Absent such a clause, the *Mobile-Sierra* balance between preserving the stability of private contracts and protecting the public interest in just and reasonable rates prevails. Preserving *joint* modification does not negate the default application of the *Mobile-Sierra* presumption when that presumption is otherwise appropriate, as the *Mobile-Sierra* presumption applies to unilateral, not joint, rate changes. Indeed, parties to energy contracts, like parties to any other contract, are free, by agreement, to vary the terms of the contract mid-term, with or without a prior pact allowing them to do so. When parties to an energy contract do so vary an agreement, sections 205 and 206 apply according to their express terms.

We therefore uphold FERC's interpretation of section 6.1 of the Power Pool agreement as reasonable.

B. Timely and Effective Review of Rates

As the parties intended *Mobile-Sierra* review to apply, we next consider whether, as FERC maintains, its blanket grant of market-based rate authority qualifies as sufficient prior review and approval of all contracts made under that authorization to trigger the *Mobile-Sierra* presumption in any later section 206 challenge. If not, then the contracts

FPA and do not trigger the *Mobile-Sierra* doctrine. We hold that although market-based rate authority *can* qualify as sufficient prior review to justify limited *Mobile-Sierra* review, it can only do so when accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change.

Two fairly recent decisions of this circuit considered the role of market-based rate authority under the FPA. In *Grays Harbor*, we held that a contract entered into during the California energy crisis pursuant to the market-based

[24]] *See* 379 F.3d at 651-52. We relied heavily on

regime offered continued and ongoing oversight and thereb

Id. at 651. On that basis, *Grays Harbor*

rates may not have historically been the type of rate envisioned by the filed rate doctrine, . . . they do not fall outside

Id.

More recently, we again stressed the need for oversight in a market-based rate regime in holding "that market-

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[[24]] The filed rate doctrine provides that state law and some federal law (e.g., antitrust) may not be used to strike down a rate subject to FERC's exclusive jurisdiction. *See Grays Harbor*, 379 F.3d at 650; *see also Davel Commc'ns, Inc. v. Qwest Corp.*, 460 F.3d 1075, 1084-86 (9th Cir. 2006) (discussing the filed rate doctrine).

based tariffs do not, *per se* *Lockyer*, 383 F.3d at 1014. *Lockyer* held the initial grant of market-based rate authority alone was not enough to assure just and reasonable rates, as FERC recognized when it "affirmed in its presentation before us that it is *not* contending that approval of a market-based tariff *based on market forces alone* would comply with the FPA or the filed rate *Id.* at 1013 (emphasis added). The court clarified further that "a market-based tariff cannot be structured so as to virtually deregulate an industry and remove it from *Id.* at 1014.

emphasis on the need for continued oversight of contract rates is critically important to our current inquiry. In *Lockyer*, California sought relief under section 205 from rates established by wholesale energy companies (many of whom are Intervenor-Respondents here) while there were dysfunctions in the spot market during the California energy crisis. The Court made the following obser-

> Despite the promise of truly competitive market-based rates, the California energy market was subjected to artificial manipulation on a massive scale. *With FERC abdicating its regulatory responsibility*, California consumers were subjected to a variety of
>
> "hockey-stick bidding," coupled with manipulative

Id. at 1014-15 (emphasis added) (footnotes omitted). Under these circumstances, the co

festly contrary to the fundamental purpose and structure of the FPA. . . . The FPA cannot be construed to immunize those who overcharge and manipulate markets in violation *Id.* at 1017.

The requirement of continued oversight in a market-based rate regime applies equally to the section 206 context, and to the application of the *Mobile-Sierra* doctrine in section 206 review. *Lockyer* flatly stated that the FPA does not allow a market-based regime

ment mechanisms sufficient to provide substitute remedies for the obtaining of refunds for the imposition of unjust,

Id. at 1016. Furthermore, *Lockyer* indicates that even in a properly approved market-based rate regime, section 206 remedies are still fully available. *See id.*

remedies [under section 206] are prospective").

Taken together, these recent circuit decisions support the following conclusion: Market-based rate authority provides a meaningful opportunity for prior review and approval of rates under the FPA, an essential prerequisite to the *Mobile-Sierra* mode of rate review, *only* insofar as FERC implements and uses an effective oversight mechanism *after* the market-based rate authorization is initially granted. Only then can FERC meet its statutory duty to ensure that *all*

This conclusion is bolstered by the judicial treatment of two similar regimes instituted by FERC in the past. In *Texaco I*, the Supreme Court considered the Federal Power

lieve[ ] them of almost all filing requirements." 417 U.S. at

rationale was that small producers would be subject to the forces of the market and could therefore only charge what the market would bear. *See id.* at 390, 94 S. Ct. 2315. The

Texaco I thus was

market-based rate authority

producers here, were asserted to lack market power and were therefore authorized to set rates with no further oversight. The assumption was that the rates set would necessarily be competitive and would therefore tend to reflect the cost of production, including the cost of attracting investment.

lation" was permissible under the Natural Gas Act, *see id.*, but struck down the order because it did not sufficiently assure *oversight*

See id. at 395-96, 94 S. Ct. 2315. The Court so held despite the FPC's assurances that it would review the prices of contracts made pursuant to this authority, *see id.* at 396-97, 94 S. Ct. 2315, stating:

> [W]e should also stress that in our view the prevailing price in the marketplace *cannot be the final measure of "just and reasonable" rates mandated by the Act.* It is abundantly clear from the history of the Act and from the events that prompted its adoption that Congress considered that the natural gas industry was heavily concentrated and that monopolistic forces were distorting the market price for natural gas. . . . In subjecting producers to regulation because of anticompetitive conditions in the industry, Congress could *not*
>
> could conclusively be determined by reference to market price.

Id. at 397-99, 94 S. Ct. 2315 (emphasis added) (footnotes omitted).

The D.C. Circuit followed *Texaco I's* approach when considering a FERC regulation for the oil industry based

ve market forces should be relied upon in the main to a *See Farmers Union*, 734 F.2d at 1490. That court was adamant in holding "FERC's largely undocumented reliance on market forces as the principal means of rate regulation to be . . .

misplaced. It is of course elementary that market failure and the control of monopoly power are central rationales for the imposition of rate regulation." *Id.* at 1508 (citing STEPHEN BREYER, REGULATION AND ITS REFORM 15-16 (1982)) (footnote omitted). Indeed, the "fundamental flaw in the Commission's scheme" was that itself acts as a monitor to see if [competition drives rates ness'] or to check rates if it does not." *Id.* at 1509.

Here, FERC failed to adopt any monitoring mechanism before applying deferential *Mobile-Sierra* review to the challenged contracts. When FERC encouraged the local utilities to purchase power in the forward market, the agency promised to oversee the forward market contracts to ensure their justness and reasonableness. *See December 15 Order*, 93 F.E.R.C. at ¶ 61,994. FERC later held, however, that its approval of energy sellers' market-based rate authority long *prior* to the market failures that gave rise to the December 15 Order allowed it to apply the *Mobile-Sierra* doctrine without any direct inquiry into whether the resulting rates were in fact "just and rea- inquiry into the actual state of the market at the time contracts were negotiated. *See Order on Initial Decision*, 103 F.E.R.C. at ¶ 62,388-89.

In light of the foregoing discussion, we must answer the crucial question: Did FERC provide sufficient oversight for contracts made under market-based rate authority to ensure that the resulting rates were within the statutory "just and reasonable" range in the first instance, thereby permitting reliance on the *Mobile-Sierra* doctrine as to the continuing effectiveness of those contracts? We hold that it did not.

FERC asserted in its Order on Initial Decision that the grant of market-based rate authority *is* sufficient predeter- quired specifically to review t to the grant of market-based rate authority. *Id.* ¶ 62,389. In other words, FERC contends that because it requires, before granting market-based rate authority, a showing of lack of market power and regular reporting, it has therefore fulfilled its oversight role, and no further oversight is necessary. FERC asserted the same position on rehearing, maintaining that its decision in *Lockyer* supports that result. *Order on Rehearing*, 105 F.E.R.C. at ¶ 61,982-83.

Lockyer decision, the agency held that once market-based rate authority is granted, additional over-

California ex rel. Lockyer, 99 F.E.R.C. ¶ 61,247 at ¶ 62,063, 2002 WL 32035504 (2002); *see also Lockyer*, 383 F.3d at 1015. We rejected this aspect of

Lockyer decision, however, because without active

Lockyer

invocation of the *Mobile-Sierra* mode of review in this case.

Lockyer, is that it fulfills its monitoring obligation by imposing on sellers with market-based rate authority the requirement that they file Quarterly Transaction Reports, make the Reports available for public review, and submit data on a triennial basis to confirm the continued lack (or mitigation) of market power. This data collection activity, however, was insufficient to fulfill FERC's statutory obligation with respect to the contracts challenged here. As demonstrated by what actually happened during the California energy crisis, this sporadic data collection approach is pragmatically unlikely to expose in a timely manner the impact of market changes in this instance, the impact on the forward market of acknowledged severe market changes within the dysfunctional spot market. That such impacts can occur without affecting that initial just and reasonableness review occurred with regard to the challenged contracts sufficient to trigger the *Mobile-Sierra* mode of review.

In particular, the quarterly reporting requirement, standing alone, permits review of the grounds for market-based rate authority only with regard to contracts entered into *after* the impact of the market dysfunction or market power on long-term bilateral contracts has already occurred, affecting the likelihood that the contracts in fact set

There is a crucial difference between this review that is, purely prospective review, affecting only future contracts and one that permits consideration of the market conditions at the time a challenged forward contract was entered. *See El Paso Elec. Co.*, 108 F.E.R.C. ¶ 61,071, at ¶ 61,370 n. 10 (2004) ("A revocation of market-based rates . . . would not

latter kind of remedy is the kind the local utilities ask for here: They seek *modification* of the contracts here at issue, prospectively from the refund effective date but based on the market circumstances that prevailed at the times the contracts were negotiated.

rate authority in Year 1. In Year 5, prices increase dramatically in short-term markets. Buyer B, needing to escape these markets, agrees to long-term contracts X, Y, and Z to buy wholesale energy from Seller A. Buyer B agrees to the contract terms because in a frantic market Seller A is one of the only suppliers willing to enter into a long-term contract, and Buyer B needs to ensure that its supply is able to meet the load required by its retail customers. In its next required quarterly report in Year 6, Seller A dutifully transfers the proper information about its rates to FERC.

FERC—perhaps reviewing contracts X, Y, and Z—discovers that the assumption of a functioning market underlying its approval of market-based rate authority for Seller A does not accord with the rates being charged in forward contracts generally, or in those entered by Seller A

based rate authority. FERC's action, however, will do nothing to reform those troubling contracts.

The problem raised by this hypothetical is that FERC has *no* opportunity to review whether contracts X, Y, and Z are just and reasonable before they are entered. As FERC recognizes, revocation of market-based rate authority in Year 6 in the above hypothetical can only provide relief for contracts made thereafter. *See id.* If a contract is entered into in Year 5, FERC cannot consider whether the basis for market-based rate authority had so atrophied by this time that the economic basis for assuming the rates established

the most-forgiving version of review, the *Mobile-Sierra* presumption that long-term bilateral contracts will reflect just and reasonable rates, without *any* opportunity for initial review of such contractual rates, whether cost or market based.

This case is precisely parallel to the above hypothetical. For example, Enron, an Intervenor-Respondent in this case, *did* have its market-based rate authority revoked, because of the actions it took during the time period in which the contracts at issue here were entered into. *Enron Power Mktg., Inc.*, 103 F.E.R.C. ¶ 61,343, at ¶ 62,302 (2003). By revoking that power, FERC restricted Enron's *prospective* power to enter into contracts. *Id.* ¶¶ 62,307-10. The very day after revoking Enron's market-based rate

to reform its contracts with Enron even though they were made during the very period FERC identified Enron as grossly abusing and violating its market-based rate authority. *See Order on Initial Decision*, 103 F.E.R.C. at ¶ 62,397. FERC accomplished this result by applying a *Mobile-Sierra* rd to the contract reformation proceedings. *See id.* By doing so, FERC neither

nor revisited the market circumstances in which the agreements were entered to determine whether those circumstances were sufficiently functional that they were likely to yield long-term contracts within the "just and reasonable" range.

This approach to section 206 review simply cannot be squared with the statutory scheme. Section 206 commands prospective revision of rates that, as of the refund effective date, are not just and reasonable: When FERC determines

determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter

U.S.C. § 824e(a). By layering *Mobile-Sierra* review on top of a market-based rate authority that can be revoked only prospectively from the refund effective date, FERC abdicates its statutory responsibility to provide such rate revision when appropriate.

FERC represents in its post-argument submission that the local utilities could have challenged the sellers market-based rate authority at the time they entered into the challenged contracts. That representation is true, but beside the point. Any such challenge, even if successful, could not have been a basis for reforming the challenged contracts, even if the excessively high rates established by the contracts were strong indications that market-based rate authority *should* be revoked. Rescission of market-based rate authority still would have affected only later contracts, leaving the challenged agreements subject to limited *Mobile-Sierra* public interest review.

As a result of FERC's refusal to consider the abrogation of market-based rate authority except with respect to future contracts, and given the dramatic and sudden nature of the onset of the California energy crisis and the limited period of time that the local utilities had to respond to it, the local utilities here had no meaningful opportunity to institute a challenge to these sellers' market-based rate authority before entering the disputed agreements. For example, in February 2001, California enacted legislation allowing its Department of Water Resources to purchase power on behalf of its deteriorating investor-owned utilities.

told Southern Cal Water that

s previous one year contract with Southern Cal Water that expired in April 2001, as

Southern Cal Water was thus left with less than two months to obtain power for the following year and only

tely negotiate a long-term contract that could take effect in April 2001; (2) shift to the spot markets, by then recognized by FERC as manipulated and dysfunctional markets that had already caused hyper-pricing and bankrupted several utility companies; or (3) shut down operation and fail to provide electricity for its retail customers. Faced with these choices, Southern Cal Water entered into a forward contract based on a bidding period of little more than two weeks. Under these time constraints, Southern Cal Water could not have challenged

from FERC, and then negotiated a forward agreement and signed a contract with the very seller whose market-based rate authority it had just challenged. There was simply no realistic way that Southern Cal Water could continue to participate in the forward market while assuring meaningful "just and reasonable" review.

Ultimately, the fatal flaw in

market changes and offers no protection to purchasers victimized by the abuses of sellers or dysfunctional market conditions that FERC itself only notices in hindsight. For example, on December 15, 2000, FERC issued an order encouraging the adoption of long-term contracts and establishing a benchmark price of $74/Mwh. *See December 15 Order*, 93 F.E.R.C. at ¶¶ 61,994-95. FERC promised

monitoring the possible exercise of market power . . . [t]o address concerns about potentially unjust and unreasonable rates

Id. ¶ 61,994. In fact, because of its flawed processes, FERC

ncerns about potentially unjust and unreasonable rates

because it had no means to revoke market-based rate authority before the precipitously entered contracts went into effect and became, in FE

FERC failed to detect that, according to its own benchmarks, something was awry in the forward markets that produced these contracts.

As in *Lockyer*, we do not dispute that FERC may adopt a regulatory regime that differs from the historical cost-based regime of the energy market, or that market-based rate authority may be a tenable choice if sufficient safeguards are taken to provide for sufficient oversight. FERC, however, cannot use that choice to excuse its duty to maintain effective oversight and then invoke *Mobile-Sierra* as a ground for precluding ordinary rate review, including review of the propriety of market-based rate authority at the time the contracts became effective. Any other conclusion would permit FERC to abdicate entirely its statutory responsibility under the FPA to ensure that *all* rates, including bilateral contract ra.

C. Meaningful Review of Contract Formation

This fundamental procedural error was compounded by *Mobile-Sierra* without regard to the market conditions in which the contracts at issue were formed. As we have explained, *Mobile-Sierra* cannot apply without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market.

The local utilities argue here that the frenzied market conditions of the California energy crisis in the spot market influenced the forward market in such a manner as to raise a question about what transpired during formation of the forward contracts here at issue. The most important evidence supporting this position is the FERC Staff Report concerning price manipulation in the western United States at the time these contracts were formed. The FERC staff concluded:

> Our analysis shows . . . that forward power prices negotiated during 2000-2001 in the western United States were *significantly influenced* by the then-current spot power prices. This tells us that the *trauma* of the dysfunctional spot power prices at that time *so influenced buyers that they placed great weight on these prices in forming future expectations.*

Staff Report at ES-9 (emphasis added). The report noted that the influence was greatest for one-to-two year forward contracts,[25

price and forward price. *Id.*

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[25] Most of the contracts challenged by Nevada Power and Sierra Pacific are within that time range.

irrelevant because they did not demonstrate that the rates in the forward contracts affec *Order on Initial Decision*, 103 F.E.R.C. at ¶ 62,397. FERC therefore did not consider the staff findings in determining *whether* the *Mobile-Sierra* doctrine was applicable to these contracts; instead, FERC discarded the findings after determining, for independent reasons, that the *Mobile-Sierra* doctrine *was* applicable. The upshot is that FERC failed ever to consider whether the influence of the spot markets on the forward markets reached a level sufficient to question whether FERC could assume that two private parties onable" contract in the first instance and therefore apply the *Mobile-Sierra* presumption.

of the market at the time the challenged contracts were negotiated are thus not responsive to the theory advanced by the local utilities here. FERC held only that because the local utilities entered into th evidence of unfairness, bad faith, or duress in the original negotiations [of the forward contracts], the [local utilities] are not entitled to change *Id.* at ¶¶ 62,399-62,400. But the local utilities do not allege that the energy companies manipulated their negotiations of the contracts here at issue; the local utilities challenge the *context*, not the conduct, of those negotiations. Consistently with the local utilities are maintaining that factors exogenous to the forward market, the dysfunction and manipulation of the spot market, artificially influenced the rates in the forward market, creating market dysfunction in the forward market.[26

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[26] FERC's premise, never examined in its orders and opinions, is that the spot and forward markets can and should be analyzed separately.

market dysfunction occurs *and* there is no opportunity to revisit the propriety of the market-based rate authority in effect when the contract was entered, FERC cannot assume that contractual terms were just and reasonable as between the contracting parties when the agreement was negotiated. As a result, FERC cannot focu
considerations when the rates established are thereafter challenged.

In this case, the questions raised by the Staff Report
whether and how the manipulated spot market influenced the forward markets
relevant to determining *whether* the *Mobile-Sierra* doctrine applies, because they raise questions about the market conditions at the time of contract formation and thus about the propriety of relying on a regime of market-based rate authority at that time to

obligated to justify deviations from an approach suggested by its own staff," when "the conceptual underpinnings of
to a reasoned resolution of
Pub. Utils. Comm'n v. FERC, 817 F.2d 858, 862-63 (D.C. Cir. 1987).

function evidence as irrelevant to the question whether *Mobile-Sierra* applies, and its resulting application of the *Mobile-Sierra* doctrine, was fundamental error. In a regulatory regime predicated on the grant of market-based rate authority, the decision whether to apply *Mobile-Sierra* to subsequent contracts formed under that authority requires FERC and reviewing courts to determine if the contracts at

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Many of the participants in the two markets are the same, however, as is the product sold—electric power. The only difference is the time frame for delivery of that product. For present purposes, we accept FERC's assumption that the two markets are sufficiently separate that there is at least a question as to the scope of the impact of the dysfunctional spot market on the forward market.

issue were initially entered into in fully functioning mar-
Mobile-Sierra doctrine
without considering the contract formation issues was error.

D.

FERC's error in its approach to deciding *whether* to apply the *Mobile-Sierra* presumption was compounded by its use of an erroneous standard for determining whether the challenged contracts affect the public interest. As our historical summary shows, electric utility deregulation has made it increasingly necessary for FERC to consider
ct on the consuming public.
In its efforts to determine the impact on the public interest under *Mobile-Sierra*, however, FERC relied on the wrong legal standard, applying factors taken from the context of a *low-rate* challenge rather than those relevant to the *high-rate* challenge present in this case.

As we discussed in Part II, state agencies in the past regulated heavily the rates charged directly to the public. Electric rate regulation reform, however, has significantly limited the role state regulators play and simultaneously increased the importance of federal regulation for the

sibility for protecting the public's interest makes its obligation to ensure that wholesale rates do not unjustifiably adversely affect the public
statutory mandate more important than it was when the *Mobile-Sierra* doctrine first developed. Because, at present, FERC, not state regulators, "is perhaps in the best position to reach the most equitable result and to act in the
Miss. Indus. v. FERC, 808 F.2d 1525, 1549 (D.C. Cir. 1987) (per curiam) (quoting *Middle S. Serv., Inc.*, 30 F.E.R.C. ¶ 63,030, at ¶ 65,151 (1985)), FERC must give predominant weight in determining whether to modify a contract under section 206 to the impact of a challenged

wholesale contract on the rates paid by the consuming public who use the energy covered by the contract. Tested against this protocol, the agency's narrow conception of

FERC determined that the challenged contract rates did not impact the public interest principally because the local utilities presented little evidence relevant to the three public interest factors specifically mentioned in *Sierra*.[27] *Order on Initial Decision*, 103 F.E.R.C. at ¶ 62,397. Simi-
urt, assume, erroneously, that
Sierra established a three-prong public interest standard applicable across all circumstances, an assumption with which we do not agree. In particular, the "excessive bur-
Sierra, heavily relied upon by FERC in
this case in concluding that there was no impact on the public interest, has no application here.

As the text from *Sierra*, reproduced in the margins, demonstrates, the three *Sierra* factors were specifically identified as relevant to the *low-rate* challenge presented in that case. Rates asserted to be *lower* than those FERC would approve *ab initio* will not ordinarily directly affect the most
namely,
avoidance of unnecessarily high rates for the consuming public. That *Sierra* does not mention such a consideration is thus no wonder. *See Ne. Utils. Serv. Co. v. FERC (Ne. Utils. II)*, 55 F.3d 686, 691 (1st Cir. 1995) (applying a
interest" in a high-rate chal-

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[27] In such circumstances[when the public interest test satisfies]

> [FERC's duty to ensure just and reasonable rates] the sole concern of the Commission would seem to be *whether the rate is so low* as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.

Sierra, 350 U.S. at 355, 76 S. Ct. 368 (emphasis added).

cf. Permian Basin Area Rate Cases, 390 U.S. 747, 783-84, 88 S. Ct. 1344, 20 L.

setting of maximum rates because of the impact on the public interest). Indeed, the D.C. Circuit has characterized *Sierra* as establishing the rule

be met before a *customer* who has negotiated a fixed-price contract can be deprived against his will of the *benefit of his bargain* *Town of Norwood*, 587 F.2d at 1310 (emphases added). When a customer has negotiated a low contract rate, FERC must meet a high burden before raising that rate. By contrast, in this case, the customer is complaining of a *high* rate. The concerns in such a high-rate case are not entirely parallel to those in a low-rate case.

The primary "public interest" at issue in a low-rate challenge, such as *Sierra*, is in keeping utilities in operation so the public is not deprived of services. *Sierra* also

other consumers an excessive burden." 350 U.S. at 355, 76 S. Ct. 368 (emphasis added). The reason for concern with

other

rates in some wholesale contracts that are too low to recoup production costs and a fair profit could lead utilities burdened with such low rate agreements to recoup their costs and profit margins by charging higher rates than are just and reasonable to other wholesale customers. Such a bur-

for costs, including the cost of capital, that properly should have been borne by the consumers who purchase energy covered by the challenged contract. Contrary to FERC's

den in *Sierra* did not signal that it is fine to burden customers with unjustifiably higher rates as long as those rates lenge, such as this one, is assuring that the consuming public pays fair rates for the very energy covered by the challenged contracts. *Sierra*

application to this direct pass-through concern. Instead, if a challenged contract imposes any significant cost on ultimate customers because of a wholesale rate too high to be within a zone of reasonableness, *see INGAA*, 285 F.3d at 31, that contract affects the public interest.

To be sure, the stability of contract considerations that underlie the *Mobile-Sierra* doctrine do carry over to challenges by buyers rather than sellers. *See Mobile*, 350 U.S.

terally" change contract bec
of contracts ... permits the stability of supply arrange-
ns, however, do not justify

the public from unjustifiably high rates in wholesale contracts.

The public interest standard, consequently, must be adjusted to give appropriate weight to that concern. In particular, in determining whether a challenged rate affects the public interest, FERC must take into account the Supreme

e determination of fair rates. *Texaco I*, 417 U.S. at 399, 94 S. Ct. 2315. In the context of a high-rate challenge, consequently, a high-rate public interest determination should focus

necessarily whether the electricity bills have increased since the signing of the contracts, but whether those bills are higher than they would otherwise have been had the challenged contracts called for rates within the just and reasonable range.

This is not to say that *any* direct impact on consumer rates is enough to demonstrate a public interest effect sufficient to displace the countervailing *Mobile-Sierra* concern with protecting the stability of contract. Market-based rate regulation presumes appropriately that a functioning marketplace will drive prices towards marginal cost, and therefore toward such a reasonable range, "at

INGAA, 285 F.3d at 31. Even if a particular rate exceeds marginal cost, however, it may still be within this reasonable range

if that higher-than-cost-based price results from normal market forces and is part of a general trend toward rates that do reflect cost. *See id.* at 32 (noting that brief spikes in pipeline rates "are completely consistent with

proper standard for the *Mobile-Sierra*

challenge is not whether the contracted rates pose an

sale energy contract is outside the "zone of reasonableness" and results in retail rates higher than would be the case if that zone were not exceeded. This standard mirrors that endorsed by the D.C. Circuit for determination of a just and reasonable rate under a market-based rate regulation regime, *see INGAA*, 285 F.3d at 31-36, and provides an appropriate context for the Su

admonition in such a regulatory environment.

After reviewing the record carefully, we are certain that FERC did not properly assess the public interest of any of the contracts before it in this case.

1. *Snohomish*

Snohomish had already increased its retail rates by 35 percent to accommodate the payment of increased prices for power, averaging $125/MWh. Because Snohomish could not obtain forward contracts that allowed it to bring the retail rates back within a normal range, it appears that the assertion, it does not matter whether a rate increase occurred before or after a petitioner signed one of the challenged contracts. *See Order on Rehearing*, 105 F.E.R.C. at ¶ 61,986. In either case, the contract could cause customers to pay higher rates than they would have without the contract. Further, FERC specifically found that the challenged Morgan Stanley contract accounted for an eight percent increase for retail ratepayers over 2001 rates. *Id.*

2. *Southern Cal Water*

FERC acknowledged that the challenged contracts led to electric bills of $35.13 per month for some Southern Cal Water customers. FERC held, however, that Southern Cal Water had not proven that su
excessive *Id.* (emphasis added).

id., is in error because, as stated above, the "excessive burden" standard, which referred in *Sierra* to the impact on third parties of a wholesale contract so low as to necessitate that costs be recouped from other buyers, does not apply in this case, and did not in any event sanction impacts on consumers as long as not in some absolute sense "excessive."

3. *Nevada Power*

lenged contracts were negotiated. *Id.* This circumstance, however, cannot alone determine whether those contracts negatively affected the public interest. The decrease from peak rates charged during the crisis does not show that the slightly lower rates that resulted from the forward contracts did not affect the public interest. It is entirely possible that rates had increased so high during the energy crises because of dsyfunction in the spot market that, even with the acknowledged decrease in rates, consumers still paid more under the forward contracts than they otherwise would have. FERC should have performed a more sophisticated economic analysis to determine if the challenged contract affected the public interest.

* * *

y18 [sic] For the foregoing reasons, we determine that a remand is necessary so that FERC can apply the proper statutory standards to determine, first, whether *Mobile-Sierra* review of the challenged contracts is appropriate; second, if so, to apply the modified form of *Mobile-Sierra* review outlined in this opinion; and finally, if not, to apply full just and reasonable review to the challenged contracts. The petition for review is hereby granted. We remand this case to FERC for proceedings consistent with this opinion.[28]

PETITION FOR REVIEW GRANTED AND REMANDED.

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[28] Petitioner Snohomish also claims (1) that two FERC commissioners engaged in ex parte communications with wholesale energy sellers in violation of Snohomish's due process rights; (2) that these same communications violated the Sunshine Act, 5 U.S.C. § 552b; and (3) that certain evidentiary rulings of the Administrative Law Judge violated Snohomish's due process rights. Because our remand order requires FERC to consider the complaints again in the first instance, we do not reach these additional issues.

APPENDIX G

RELEVANT STATUTORY PROVISIONS

1935, tit. II, ch. 687, 49 Stat. 803, 838-63 codified as amended at 16 U.S.C. §§ 791a-825r, provides, in relevant part:

§824d. Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five-month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practices; action by Commission; "automatic adjustment clause" defined

(1) Not later than 2 years after November 9, 1978, and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjust-

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are--

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

§ 824e. Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues

Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

(b) Refund effective date; preferential proceedings; statement of reasons for delay; burden of proof; scope of refund order; refund orders in cases of dilatory behavior; interest

Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date of the filing of such complaint nor later than 5 months after the filing of such complaint. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date of the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the publication date. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: *Provided*, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Refund considerations; shifting costs; reduction in revenues; "electric utility companies" and "registered holding company" defined

Notwithstanding subsection (b) of this section, in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) of this section shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company: *Provided,* That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of the Commission's order. For purposes of this subsection, the terms "electric utility companies" and "registered holding company" shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended [15 U.S.C.A. § 79 et seq.].

(d) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

(e)(1) In this subsection:

(A) The term "short-term sale" means an agreement for the sale of electric energy at wholesale in interstate commerce that is for a period of 31 days or less (excluding monthly contracts subject to automatic renewal).

(B) The term "applicable Commission rule" means a Commission rule applicable to sales at wholesale by public utilities that the Commission determines after notice and comment should also be applicable to entities subject to this subsection.

(2) If an entity described in section 824(f) of this title voluntarily makes a short-term sale of electric energy through an organized market in which the rates for the sale are established by Commission-approved tariff (rather than by contract) and the sale violates the terms of the tariff or applicable Commission rules in effect at the time of the sale, the entity shall be subject to the refund authority of the Commission under this section with respect to the violation.

(3) This section shall not apply to—

(A) any entity that sells in total (including affiliates of the entity) less than 8,000,000 megawatt hours of electricity per year; or

(B) an electric cooperative.

(4)(A) The Commission shall have refund authority under paragraph (2) with respect to a voluntary short term sale of electric energy by the Bonneville Power Administration only if the sale is at an unjust and unreasonable rate.

(B) The Commission may order a refund under subparagraph (A) only for short-term sales made by the Bonneville Power Administration at rates that are higher than the highest just and reasonable rate charged by any other entity for a short-term sale of electric energy in the same geographic market for the same, or most nearly comparable, period as the sale by the Bonneville Power Administration.

(C) In the case of any Federal power marketing agency or the Tennessee Valley Authority, the Commission shall not assert or exercise any regulatory authority or power under paragraph (2) other than the ordering of refunds to achieve a just and reasonable rate.

* * *

§ 825*l*. Review of orders

(a) Application for rehearing; time periods; modification of order

Any person, electric utility, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, electric utility, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any entity unless such entity shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b) of this section, the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

(b) Judicial review

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States Court of Appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of Title 28.

(c) Stay of Commission's order

The filing of an application for rehearing under subsection (a) of this section shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

FILED

AUG 6 - 2007

OFFICE OF THE CLERK
SUPREME COURT, U.S.

⑨ ⑧ ⑦

Nos. 06-1454, 06-1457, 06-1462 and 06-1468

IN THE SUPREME COURT OF THE UNITED STATES

Sempra Generation, *et al.*, *Petitioners*,
v.
Public Utilities Commission of the State of California, *et al.*,
Respondents.

Morgan Stanley Capital Group Inc., *et al.*, *Petitioners*,
v.
Public Utility District No. 1 of Snohomish County Washington,
et al., *Respondents*.

Calpine Energy Services, L.P., *et al.*, *Petitioners*,
v.
Public Utility District No. 1 of Snohomish County Washington,
et al., *Respondents*.

Dynegy Power Marketing, Inc., *et al.*, *Petitioners*,
v.
Public Utilities Commission of the State of California, *et al.*,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF IN OPPOSITION OF PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, NEVADA POWER COMPANY, SIERRA PACIFIC POWER COMPANY, GOLDEN STATE WATER COMPANY, AND OFFICE OF THE NEVADA ATTORNEY GENERAL, BUREAU OF CONSUMER PROTECTION

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PARTIES TO THE PROCEEDING

In the litigation below, respondent Public Utility District No. 1 of Snohomish County, Washington ("Snohomish"), was a petitioner in *Public Utility District No. 1 of Snohomish County v. FERC* in the Ninth Circuit and a complainant in the underlying administrative proceedings before FERC. Snohomish was an intervenor in *Public Utilities Comm'n v. FERC* in the Ninth Circuit and in the underlying administrative proceedings before FERC.

Respondent Golden State Water Company was known by its former corporate name, Southern California Water Company. It was a petitioner in *Public Utility District No. 1 of Snohomish County v. FERC* in the Ninth Circuit, and a complainant in the underlying FERC proceedings. Golden State Water Company was an intervenor in *Public Utilities Comm'n v. FERC*.

Respondents Nevada Power Company and Sierra Pacific Power Company were petitioners in *Public Utility District No. 1 of Snohomish County Washington v. FERC* in the Ninth Circuit, and complainants in the underlying FERC proceedings. Respondents Nevada Power Company and Sierra Pacific Power Company were intervenors in *Public Utilities Commission of California v. FERC* in the Ninth Circuit and in the underlying FERC proceedings.

Respondent Office of the Nevada Attorney General, Bureau of Consumer Protection ("Nevada BCP") was an intervenor before FERC and a petitioner in *Public Utility District No. 1 of Snohomish County v. FERC* in the Ninth Circuit.

RULE 29.6 STATEMENT

Public Utility District No. 1 of Snohomish County, Washington ("Snohomish") is a municipal corporation and a subdivision of the State of Washington formed under Title 54 of the Revised Code of Washington by a vote of the people of Snohomish County, Washington, in 1936. Snohomish issues no stock and is prohibited by the Constitution of the State of Washington from holding stock in any private corporation.

Golden State Water Company's parent company is American States Water Company. American States Water Company has no parent company, and no publicly held company owns more than 10% of its stock.

Nevada Power Company has 100% of its stock owned by Sierra Pacific Resources, a publicly held corporation.

Sierra Pacific Power Company has 100% of its stock owned by Sierra Pacific Resources, a publicly held corporation.

The Nevada Bureau of Consumer Protection operates within the Office of the Nevada Attorney General pursuant to Nev. Rev. Stat. § 228.310, and may represent the interests of Nevada utility consumers before FERC and the federal courts pursuant to Nev. Rev. Stat. § 228.360.

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STATEMENT

In these cases, the Ninth Circuit applied the Federal Power Act ("FPA") and this Court's decisions construing it to review orders of the Federal Energy Regulatory Commission ("FERC") addressing the lawfulness of wholesale electricity rates in contracts signed during the western energy crisis of 2000-2001. The court held that FERC may not presume that a "market-based" contract rate is lawful under the statute where the rate has never been subject to FERC's review and FERC has not ensured that the contract was entered into in a properly functioning market. The court further held that, in cases where this presumption applies, the factors relevant to determining whether a contract rate is too low do not exhaust the factors relevant to determining whether a contract rate is too high. The Ninth Circuit remanded the case and left substantial discretion to FERC, which, accordingly, has not petitioned for review.

1. Background

Congress enacted the FPA in 1935 because it concluded that federal regulation of the interstate sale and transmission of electricity "is necessary in the public interest." 16 U.S.C. § 824(a). The FPA's primary purpose is "to protect power consumers against excessive prices." *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414, 418 (1952). To that end, Section 205 requires that "[a]ll rates and charges made, demanded, or received" by any regulated entity "for or in connection with the . . . sale of electric energy subject to the jurisdiction of the Commission . . . shall be just and reasonable" and declares that any rate or charge not meeting the just and reasonable standard is "unlawful." 16 U.S.C. § 824d(a). Section 206, in turn, provides that whenever FERC finds that "any rate, charge, . . . or contract affecting such rate [or] charge" is "unjust, unreasonable, unduly discriminatory or preferential," it must "determine the just and reasonable rate, charge . . . or contract." *Id.* § 824e(a).

In 1956, this Court held, in cases construing the FPA and the "substantially identical" provisions of the Natural Gas Act ("NGA"), that a regulated utility may not employ the rate filing provisions of those acts unilaterally to increase the rates in a contract – in each case, previously filed with the Commission and formed under circumstances that were unchallenged – "solely because [the contract] yields less than a fair return." *FPC v. Sierra Pacific Power Co.,* 350 U.S. 348, 355 (1956); *United Gas Pipe Line Co. v. Mobile Gas Service Corp.,* 350 U.S. 332, 343-44 (1956). The Court emphasized that its holding "in no way impairs the regulatory powers of the Commission, for the contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest," but distinguished the seller's "private interest" in increasing a contract rate from the interests of "those who represent the public interest or those who might be discriminated against." *Id.* at 344-45. The "*Mobile-Sierra* doctrine" thus recognizes that, while the statutes are "premised upon a continuing system of private contracting, . . . the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968).

For most of the FPA's history, FERC (and its predecessor, the Federal Power Commission ("FPC")) operated under a regulatory regime in which sellers filed tariffs with FERC specifying the rates they intended to charge, subject to being disapproved by the agency if they were not "just and reasonable" based on the cost to the seller of providing the service plus a fair return on invested capital. In the 1990s, based on its view that competition among wholesalers could obviate the need for traditional cost-based regulation, FERC began to move to a new "market-based" regulatory regime with relaxed rate-filing requirements. If a seller can establish that it lacks market power or has mitigated its ability to exercise market power, the Commission will give it authority to negotiate rates in the marketplace, with those rates automatically taking effect, and sellers' transactions reported only quarterly to the Commission. *See California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1009 (9th Cir. 2004), *cert denied*, 127 S. Ct. 2972 (2007). Under this regime, particular *rates* are no longer even filed, let alone reviewed, before they take effect. Instead, the Commission relies generally on the presumption that "[i]n a *competitive* market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of [a] voluntary exchange are reasonable, and specifically to infer that price is close to marginal cost, such that the seller makes only a normal return on its investment." *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990). (emphasis added).

This Court has recognized that FERC's authority to rely on market-based contract rates is necessarily limited by the statutory command that rates be just and reasonable. In 1970, the FPC relieved small natural gas producers from most of the NGA's filing requirements and assured those producers that their contract rates would not be subject to change, reasoning that competition from larger producers would keep the rates charged by smaller producers in check. *FPC v. Texaco Inc.*, 417 U.S. 380, 384 (1974). This Court held "that the Commission lacks the authority to place exclusive reliance on market prices." *Id.* at 400. The Court agreed that "the Commission may have great discretion as to how to insure just and reasonable rates," but held that the Commission must insure that "the rates paid by pipelines, and ultimately borne by the consumer, are just and reasonable." *Id.* at 394, 401. Thus, *Texaco* makes clear that FERC's reliance on market forces must co-exist with regulatory oversight under the FPA.

2. The Western Energy Crisis

The western energy crisis of 2000-2001 involved an unprecedented combination of market failures, *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,121, p. 61,349-50 (2000), market manipulation, *Enron Power Mktg., Inc.*, 103 FERC ¶ 61,343, p. 62,301 (2003), and "abdicati[on]" by FERC of its regulatory responsibility, *Lockyer*, 383 F.3d at 1015. Wholesale electricity expenditures in California more than quadrupled (from $2.04 billion to $8.98 billion) between summer 1999 and summer 2000, with 59% of the increase attributable to market power, according to a study by the University of California. ER 1045-46.[1]

The market problems first manifested themselves in the organized "spot markets" for electricity in California, although the adverse effects of market dysfunction quickly became evident in the forward bilateral contract markets as well.[2] On November 1, 2000, FERC concluded that the California market structure and rules were "seriously flawed" and "provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates." *San Diego,* 93 FERC at 61,349-50. At the same time, FERC concluded that "higher spot market prices in turn affect the prices in forward markets." *Id.* at 61,367. By December 15, 2000, FERC had "no assurance that rates will not be excessive relative to the benchmarks of producer costs or competitive market prices," and concluded that "unjust and unreasonable rates . . . could continue to be charged unless remedies are implemented." *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,294, p. 61,999 (2000).

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[1] The "ER" references in this brief are to the Excerpts of Record filed in the Ninth Circuit.

[2] Spot market sales are for 24 hours or less and are entered into the day of or the day prior to delivery. *See San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 95 FERC ¶ 61,418, p. 62,545 n.3 (2001). The long-term bilateral (or "forward") markets are informal, decentralized markets in which energy is sold in advance using forward contracts – agreements for the future delivery of energy at an agreed-upon price (the "forward price"). *See* Steven Stoft, Power System Economics 90, 203-04, 446, (2002).

California is part of a single integrated electricity market in the West, *e.g., Avista Corp.*, 96 FERC ¶ 61,058, p. 61,179 (2001), *order clarified, Avista Corp.*, 96 FERC ¶ 61,265 (2001), and therefore the market dysfunctions in California "resulted in a dysfunctional marketplace both in California and the remainder of the West." *San Diego,* 95 FERC ¶ at 62,556. For example, in the Pacific Northwest, where wholesale prices historically averaged approximately $24 per megawatt-hour ("MWh"), short-term prices increased to $200 to $500 per MWh for extended periods. Pet. App. 25a.[3]

Because "maintaining an accurately priced spot market is the single most important element for disciplining longer term transactions," *AEP Power Mktg., Inc.,* 97 FERC ¶ 61,219, at p. 61,972 (2001), "[t]hese higher spot market prices in turn affect[ed] the prices in forward markets," *San Diego,* 93 FERC at

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[3] The "Pet. App." references in this brief are to the appendix filed by Calpine Energy Services, L.P., in No. 06-1462.

61,367 (2000). Thus, long-term rates also reached unprecedented levels across the West. ER 1040-41.

In a series of orders, each one implementing more comprehensive remedies than the one before it, FERC attempted to address the crisis. Significantly, FERC's initial "fundamental remedy" in its December 15, 2000, order was to have California's largest utilities sign long-term purchase contracts instead of purchasing in the spot markets. *San Diego*, 93 FERC at 61,992-93. It terminated the FERC-regulated tariff for California's main organized spot market and "strongly urge[d]" utilities "to move their load to long-term contracts of two years or more." *Id.* at 61,993.

Recognizing that abruptly moving much of California's demand to the forward market might drive up long-term contract prices, FERC promised that it would "be vigilant in monitoring the possible exercise of market power." *Id.* at 61,994. Because of "concerns about potentially unjust and unreasonable rates in the long-term markets," FERC pledged to "monitor prices in those markets" and "adopt[ed] a benchmark that we will use as a reference point in addressing any complaints regarding the pricing of long-term contracts negotiated over the next year, after which time the sudden increase in forward demand will have subsided." *Id.* FERC set this benchmark price at $74 per megawatt-hour (MWh) for "five-year contracts for supply around-the-clock." *Id.* at 61,994-95.

Neither FERC's order moving purchases from spot to forward markets nor its other incremental remedial steps ameliorated the crisis. Finally, in June 2001, FERC implemented price mitigation around the clock in the spot market throughout the western United States. *See San Diego*, 95 FERC ¶ 61,418. After this step, both spot and forward prices quickly dropped back to ordinary levels. ER 878-79.

In the midst of the market "meltdown," *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 105 FERC ¶ 61,066, p. 61,371 (2003), respondents Public Utility District No. 1 of Snohomish County, Washington ("Snohomish"), Nevada Power Company ("Nevada"), Sierra Pacific Power Company ("Sierra") and Golden State Water Company ("GSWC") (collectively, "Western Utilities") faced the task of acquiring power to serve the needs of their retail utility customers. Reflecting the severely dysfunctional state of the market at the time, the prices in the Western Utilities' contracts were substantially higher than the Commission's $74 per MWh benchmark just-and-reasonable price – sometimes, *multiples* of that price. For example, some Nevada Power contracts with Enron set a price of $290 per MWh. GSWC's cost of baseload energy for its ratepayers more than doubled – from $35.50 per MWh to $95.00 per MWh – under the five-year contract it entered. Pet. App. 28a-29a.

These contracts placed enormous burdens on consumers. For example, by March of 2002 Snohomish had suffered a net loss of approximately $26 million under its contract with MSCG and projects it will lose more than $150 million over the life of the contract – losses which must be borne by its electric consumers. ER 837.[4]

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[4] Relying on FERC's flawed factual findings, Morgan Stanley Capital Group Inc. (MSCG) claims (Pet. 5) Snohomish made a profit over the first five months of 2001 by reselling power from MSCG's contract at inflated prices. But MSCG did not begin delivering power to Snohomish until April 1, 2001, and FERC intervened to correct market prices in June 2001, after which prices were generally well below the $105 per MWh rate in the MSCG contract. Therefore, Snohomish could have profited only for the first two or three months of the 108-month contract.

3. The Decisions Below

The Western Utilities filed complaints at FERC pursuant to Section 206 of the FPA, arguing that because the market was dysfunctional when these contracts were formed, and the contract rates substantially exceeded FERC's benchmark price, FERC should prospectively reform the contract rates to just and reasonable levels. The Nevada Attorney General's Bureau of Consumer Protection (BCP) intervened to fulfill its mandate to represent the interests of Nevada utility consumers. After setting for hearing the issue of whether the dysfunctional California spot markets adversely affected prices in long-term bilateral contracts (Pet App. 269a, 317a (citing order)), FERC denied the complaints without reaching that issue or determining whether the Western Utilities' contracts were unjust and unreasonable. Pet. App. 292a-293a.

FERC ultimately concluded that whether the contract rates were just and reasonable was irrelevant. In FERC's view, "a finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a 'just and reasonable' standard of review." *Id.* at 292a. Here, FERC held that the just and reasonable standard of review was not available to the Western Utilities since FERC had "pre-determine[d]" that the rates were just and reasonable – in some cases years earlier – when it granted Enron and the other sellers blanket authority to sell electricity at market-based rates. *Id.* at 322a-23a, 325a. Pointing to this Court's decisions in *Mobile* and *Sierra*, FERC maintained that the rates included in a contract executed pursuant to such blanket market-based rate authority were subject only to the "public interest" standard, which FERC viewed as entirely separate from the "just and reasonable" standard. FERC evaluated the contract rates under the "Sierra Three-Prong Test," *id.* at 293a – the three factors mentioned in *Sierra* as bearing on whether contracts rates were *too low*. FERC also purported to apply what it characterized as a "[t]otality of [c]ircumstances" analysis, which, notwithstanding the expansiveness of its title, focused primarily on the purchasing practices of the Western Utilities without considering the broader dysfunction of the markets in which the purchases were made. *Id.* at 296a. Concluding that the Western Utilities had not justified relief under its conception of the public interest standard, FERC denied relief.

The Ninth Circuit, recognizing that it was the first court to address the application of the *Mobile-Sierra* doctrine to FERC's more recent market-based rate regime, *id.* at 9a-10a, held that FERC had committed several errors in invoking *Mobile-Sierra* to reject the complaints.[5] First, agreeing with FERC's own view that "an opportunity for initial review of whether a rate is just and reasonable is necessary for *Mobile-Sierra* to apply," *id.* at 39a, the court concluded that FERC had not provided such an opportunity in the regulatory system for market-based rates that it had in place at the time. FERC's *ex ante* review of sellers' market power was not alone adequate, the court held, but must include sufficient monitoring and oversight "to ensure that the resulting rates were within the statutory 'just and reasonable' range in the first instance." *Id.* at 51a; *see id.* at 46a-57a. Here, despite promising to oversee long-term contracts and adopting a benchmark price,

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[5] The same Ninth Circuit panel issued two decisions the same day. The first (Pet. App. 1a-67a) resolved challenges brought by the Western Utilities. The second (Pet. App. 364a-80a) resolved challenges brought by the California Public Utilities Commission and the California Electric Oversight Board.

"FERC failed to adopt *any* monitoring mechanism before applying deferential *Mobile-Sierra* review to the challenged contracts." *Id.* at 50a (emphasis added).

Second, the court held that FERC had unduly restricted the substantive scope of the review necessary before the *Mobile-Sierra* presumption applies. In particular, the review must "focus on whether the original negotiations occurred in a functional marketplace such that we may presume the contracted rates were originally just and reasonable." Pet. App. 42a, 57a, 60a. Here, a detailed analysis by FERC's own staff made well-supported findings that gross malfunctions in the spot market corrupted prices in the forward market (*id.* at 58a), yet FERC deemed such facts "irrelevant" when invoking the *Mobile-Sierra* presumption. *Id.* But "the questions raised by the Staff Report – whether and how the manipulated spot market influenced the forward markets – *are* relevant to determining whether the *Mobile-Sierra* doctrine applies, because they raise questions about the market conditions at the time of contract formation and thus about the propriety of relying on a regime of market-based rate authority at that time to produce just and reasonable rates." *Id.* at 60a. FERC committed "fundamental error" in treating "the market-function evidence as irrelevant to the question *whether Mobile-Sierra* applies." *Id.* at 60a (emphasis in original).

In addition to these errors in determining whether *Mobile-Sierra* applied, the court held that FERC also had improperly defined the content of the *Mobile-Sierra* "public interest standard" if and when it does apply in a challenge alleging rates are too high. The court observed that "FERC determined that the challenged contract rates did not impact the public interest principally because the [Western Utilities] presented little evidence relevant to the three public interest factors specifically mentioned in *Sierra*." *Id.* at 61a-62a (footnote omitted). The Ninth Circuit concluded that FERC had incorrectly assumed "that *Sierra* established a three-prong public interest standard applicable across all circumstances." *Id.* at 62a. But, the court explained, the factors applicable to a low-rate challenge are not necessarily the same as the factors applicable to a high-rate challenge. *Id.* at 61a-64a. The court thus held "that FERC did not properly assess the public interest of any of the contracts before it in this case." *Id.* at 65a.

The court of appeals remanded the case involving the Western Utilities to FERC to reconsider the complaints. *Id.* at 4a. It did the same in the companion case. *Id.* at 367a.

ARGUMENT

The Ninth Circuit's decisions are correct under the FPA and consistent with this Court's decisions, including *Mobile* and *Sierra*. The decisions – the first to apply *Mobile-Sierra* to FERC's market-based rate regime – do not conflict with decisions of any other circuit. In addition, as confirmed by FERC's determination not to seek review by this Court, the decisions leave ample discretion for FERC to preserve its commitment to market-based rates while intervening in true episodes of market dysfunction like the 2000-2001 western energy crisis. Those facts, plus the interlocutory posture of these cases and the significant changes FERC already has made in the regulatory regime that gave rise to these cases, make review inappropriate.

I. The Decisions Below Are Consistent With The Statute And This Court's Decisions.

A. The Statute

The FPA requires unambiguously that "*[a]ll* rates and charges made, demanded, or received" for wholesale electric services "*shall* be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be *unlawful.*" 16 U.S.C. § 824d(a) (emphasis added). The "just and reasonable" requirement lies at the "heart" of the Act's regulatory system. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 611 (1944). The Ninth Circuit's rulings embody a logical application of the categorical command "that *all* rates be 'just and reasonable.'" Pet. App. 35a.

The Ninth Circuit sensibly reasoned that a rate in a contract cannot be presumed just and reasonable where the market giving rise to the contract does not produce competition sufficient to drive rates to just and reasonable levels and FERC has no effective means to monitor the rates. It further sensibly recognized that the circumstances that can make a presumption of lawfulness unjustified are not limited to the market power or transaction-specific misconduct of a particular seller. They also include structural problems in the market and the market-wide consequences of the misconduct or abuse of market power by other sellers – such as those at work in 2000-2001 in the western United States.

In determining when the *Mobile-Sierra* presumption applies, the Ninth Circuit drew a logical statutory conclusion: where the market was not functioning properly at the time of contract formation, and there was no adequate opportunity for regulatory review of rates set in the marketplace, there is no basis to presume that market-based contract rates are necessarily just and reasonable. As to what *Mobile-Sierra* means when it applies, the Ninth Circuit drew similarly straightforward conclusions: that the statute requires all wholesale rates to be "just and reasonable," and that, particularly given the statutory purpose of protecting consumers, the factors that may make a contract rate too low are not necessarily the same as the factors that may make a contract rate too high. These are the minimal logical implications of the statute.

B. *Mobile* and *Sierra*

This Court's decisions in *Mobile* and *Sierra* were decided decades before the advent of a "market-based" rate regime (where review of sellers substitutes for review of rates). In those cases, the Court rejected the attempt of regulated sellers to unilaterally raise contract rates they had filed with the Commission where those rates had been subject to Commission review, subject to protest, and in effect for years without any question about the circumstances existing at contract formation. The Ninth Circuit's decisions are fully in accord with *Mobile* and *Sierra*.

In *Sierra,* in order to "forestall the potential competition" created by the Shasta Dam's unused generating capacity, the seller contractually agreed to sell power "at a special low rate." 350 U.S. at 352. Then, once power from the dam was no longer available, the seller unilaterally filed a tariff purporting to increase the contract rate by 28%. *Id.* Similarly, in *Mobile,* the pipeline seller agreed to provide gas under a long-term contract at a special low rate to a local distribution company, which in turn agreed to resell the gas under a long-term contract to an industrial facility as an inducement to locate in the city. Then, after these arrangements were in place and sales had begun, the pipeline unilaterally filed a tariff seeking to substantially increase the contract rate. *Mobile*, 350 U.S. at 335. The contracts the sellers sought to abrogate had been filed with the Commission with public notice and an opportunity for review of the contract rates, and there was no indication of dysfunction in the market at contract formation. In these circumstances, this Court held that the Act did not authorize the sellers' abrogation of the pre-existing rates to obtain higher rates unless the pre-existing rates were contrary to the "public" interest, not merely the sellers' private interest. *Mobile*, 350 U.S. at 339, 344; *Sierra*, 350 U.S. at 355.

Although petitioners at times seem to suggest otherwise, this Court in *Mobile* and *Sierra* nowhere said that rates are immune from the statutory command that rates be just and reasonable just because they were adopted in contracts.[6] Nor did this Court hold all contracts immune from regulatory review, regardless of the circumstances. To the contrary, the Court emphasized that, while rates may be "established initially by contract," all contracts must be filed with the Commission to allow for their "supervision" by the Commission for "the protection of the public interest," *Mobile*, 350 U.S. at 339; that "all rates are subject to being modified by the Commission upon a finding that they are unlawful," *id.* at 341; and that its holding "in no way impairs the regulatory powers of the Commission to . . . modify [contracts] when necessary in the public interest," *id.* at 344. For its part, the Ninth Circuit here expressly recognized the "stability of contract considerations that underlie the *Mobile-Sierra* doctrine" and did no more than require compliance with the basic statutory command, logically applied. Pet. App. 63a.

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[6] Petitioners Calpine, Allegheny, and MSCG, respondent Mirant, and others recognized this point when they promptly sought clarification or rehearing of FERC's order below, fearing that it "could be construed as suggesting incorrectly that the *Mobile-Sierra* doctrine sanctions unjust and unreasonable rates." ER 356B. They insisted that the doctrine merely addresses what the statutory just-and-reasonable standard means in certain contract situations. *Id.* at 356B-356G.

More particularly, the Court in *Mobile* and *Sierra* did not rule, and could not have ruled, that a contract rate may be presumed just and reasonable so as not to injure the public even where the contract has never been filed with an opportunity for review in the Commission or the contract was formed in a dysfunctional market. Neither circumstance existed in *Mobile* and *Sierra*. The contracts had been filed with the Commission, affording it an opportunity to review them before allowing them to take effect. *Id*. at 39a.[7] And there was no issue about the circumstances existing at contract formation in *Mobile* and *Sierra*, while market dysfunction resulting from the western energy crisis is the central problem in the present cases. Thus, the Ninth Circuit's ruling that FERC must "have an opportunity for some initial review of rates" and "the scope of that review must permit consideration of the factors relevant to the propriety of the contract's formation" before the presumption of legality is triggered, *id*. at 41a, does not conflict with *Mobile* and *Sierra* (emphasis omitted).

Similarly, nothing in the Ninth Circuit's decision about when rates might be *too high* (even where the presumption of *Mobile* and *Sierra* applies) conflicts with *Sierra*'s discussion of circumstances that might justify contract abrogation when a *seller* seeks to increase rates that are allegedly *too low*. *Sierra*'s discussion is by its very terms not exhaustive even as to the low-rate situation, and its essential point is that a contract rate cannot be unreasonable to consumers "solely because it yields less than a fair return on the net invested capital." *Sierra,* 350 U.S. at 355. The *Sierra* discussion does not speak at all to the factors that apply when a contract rate might be *too high*. Even petitioner Sempra (Pet. 7) appears to recognize "that *Sierra* only 'gave examples of factors that would meet the 'public interest' standard." Contrary to Dynegy's complaint about "asymmetric standards" (Dynegy Pet. 25), the too-high/too-low distinction is hardly an unnatural one in a statute whose essence is to protect *consumers*. *See Pennsylvania Water,* 343 U.S. at 418.

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[7] Dynegy emphasizes (Pet. 21-22) that, unlike the other contracts, its contract actually was filed with FERC. However, while the contract was filed, it was not subject to review and not subject to challenge. *See GWF Energy, LLC*, 97 FERC ¶ 61,297at 62,391 (2001).

In short, only by misreading *Mobile* and *Sierra*, and disregarding the sharp differences in the relevant regulatory and market circumstances, can petitioners posit an incompatibility with the Ninth Circuit's rulings. The decisions are fully in accord.

C. Other Decisions Of This Court

The Ninth Circuit's conclusions are consistent not only with *Mobile* and *Sierra,* but also with every other relevant decision of this Court construing the FPA or NGA. Petitioners' views, in contrast, contradict such decisions at every turn.

The Ninth Circuit's conclusion that FERC must have an opportunity to consider the factors relevant to a contract's formation (Pet. App. 41a), unlike petitioners' view, reflects this Court's conclusion that FERC must have "an opportunity *in every case* to judge the reasonableness of the rate" in a contract. *Arkansas Louisiana Gas Co. v. Hall,* 453 U.S. 571, 582 (1981).[8]

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[8] MSCG contends that its contract with Snohomish contained a specific provision, Section 39B, barring changes in rates. MSCG Pet. 5. MSCG misreads the provision, as did FERC. Properly read, Section 39B permits Snohomish to challenge the *length* of its agreement, and that is what Snohomish actually

The Ninth Circuit's insistence on co-existence of contract stability with FERC regulation, unlike petitioners' view, accords with this Court's explanation that "there were *two* sources of price and supply stability inherent in the regulatory system established by [the FPA] – the provisions of private contracts *and* the public regulatory power." *Sunray Mid-Continent Oil Co. V. FPC,* 364 U.S. 137, 155-56 (1960) (emphases added). The Ninth Circuit's statutory rulings, unlike petitioners' views, also respect this Court's recognition of "the purposes for which the [FPA] was adopted" (*NAACP v. FPC,* 425 U.S. 662, 669-70 (1976)) – "to curb abusive practices of public utility companies by bringing them under effective control, and to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce." *Gulf States Utils. Co. v. FPC,* 411 U.S. 747, 758 (1973). *Cf. Atlantic Refining Co. v. Pub. Serv. Comm'n of New York,* 360 U.S. 378, 388 (1959) (NGA "afford[s] consumers a complete, permanent and effective bond of protection from excessive rates and charges"); *Hope,* 320 U.S. at 610 (the "primary aim" of the NGA "was to protect consumers against exploitation at the hands of natural gas companies").

Although petitioners suggest that this Court has all but forbidden Commission contract reformation, this Court has concluded that the *Mobile-Sierra* doctrine preserves FERC's "plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests," *Permian Basin,* 390 U.S. at 784, and "does not affect the supremacy of the Act itself," *Arkansas Louisiana,* 453 U.S. at 582. Hence, in

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challenges. The Ninth Circuit did not need to reach the Section 39B issue. Pet. App. 42a n.22. Even if its decision were to be overturned, the result with respect to Snohomish would not change under a proper reading of Section 39B.

Permian Basin, this Court *upheld* the FPC's *abrogation of contract terms* that were inconsistent with both the price ceiling and price floor established in natural gas "area rate" proceedings – as well as its refusal to abrogate some existing contract prices below the maximum area rates. 390 U.S. at 783-84, 818-22. *Accord FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 646-47 (1972) (upholding FERC orders amending contracts in light of natural gas market dysfunction).

In *Texaco*, the Court held that "the Commission lacks the authority to place exclusive reliance on market prices." 417 U.S. at 400. Petitioners' contention that FERC must uphold contracts even when market dysfunction or anti-competitive conduct drives rates to unreasonably high levels is not consistent with *Texaco* or this Court's other decisions. In contrast, the Ninth Circuit's conclusion that FERC must ensure that market-based contracts are "initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market," Pet. App. 57a, is fully consistent with this Court's jurisprudence.

II. The Ninth Circuit's Decisions Do Not Conflict With Other Circuits' Law.

The Ninth Circuit decisions create no intercircuit conflict. As the Ninth Circuit correctly recognized, its decisions are the first to address application of the *Mobile-Sierra* doctrine to rates adopted under the Commission's market-based regime (which FERC has since modified to provide better oversight). Pet. App. 9a-10a. The cases addressing *Mobile-Sierra* cited by petitioners – with one exception, all from the D.C. Circuit or the First Circuit – arise entirely from traditional cost-based rate-filing regimes.[9] In addition, whereas the Ninth Circuit cases address challenges by buyers to contract rates that are alleged to be too high, most earlier cases addressed sellers' challenges to contract rates alleged to be too low. As the First Circuit noted, "[v]ery little useful precedent exists" addressing "high-rate" cases. *Boston Edison*, 233 F.3d at 68. The Ninth Circuit carefully addressed other circuits' decisions and reached conclusions in harmony with them, as well as with the statute and this Court's precedents.

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[9] MSCG (Pet. 18) claims that *Boston Edison Co. v. FERC*, 233

A. The D.C. Circuit

The Ninth Circuit's focus on the need for an opportunity for effective review of rates is fully consistent with the D.C. Circuit's decisions upholding FERC's use of market-based rates – decisions that themselves rely on FERC's assurances that it would interpose regulatory remedies when market flaws threaten to produce rates outside the "zone of reasonableness." *Interstate Natural Gas Assoc. v. FERC,* 285 F.3d 18, 30-31 (D.C. Cir. 2002); *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) ("FERC has made it clear that it will exercise its § 5 authority (upon its own motion or upon that of a complainant) to assure that a market (*i.e.*, negotiated) rate is just and reasonable."); *Louisiana*

F.3d 60 (1st Cir. 2000), and *Transmission Access Policy Study Group v. FERC,* 225 F.3d 667 (D.C. Cir. 2000) ("*TAPS*"), *aff'd, New York v. FERC*, 535 U.S. 1 (2002), concerned "contracts entered into under the modern regulatory regime." But *Boston Edison* involved traditional rate-of-return contracts for output from a nuclear plant that were filed with the FPC in 1972 and amended in 1985. 233 F.3d at 61-63. In *TAPS* the D.C. Circuit approved FERC's policy allowing customers to *modify* unjust and unreasonable wholesale electricity requirements contracts that "were entered into during an era in which transmission providers exercised monopoly control over access to their transmission facilities." 225 F.3d at 712 (citation omitted).

Energy & Power Auth. v. FERC, 141 F.3d 364, 369-71 (D.C. Cir. 1998) (pointing to the "escape hatch" or "safeguard" of further Commission review should markets fail). Indeed, the D.C. Circuit has made clear that relying on market forces *alone* "does not comport with FERC's statutory responsibilities" where "nothing in the regulatory scheme itself acts as a monitor" to ensure that rates stay within the "zone of reasonableness." *Farmers Union Central Exchange, Inc. v. FERC,* 734 F.2d 1486, 1501-09 (D.C. Cir. 1984). The Ninth Circuit's central conclusion that FERC failed to provide any effective oversight mechanism is fully consistent with these D.C. Circuit cases.

The Ninth Circuit's decisions are also consistent with D.C. Circuit cases construing the *Mobile-Sierra* doctrine. As the D.C. Circuit recently noted, before 2006 it "only had occasion to apply the *Mobile-Sierra* public interest standard to FERC-*approved* contracts rather than those submitted to FERC for initial approval." *Maine Pub. Serv. Comm'n v. FERC,* 454 F.3d 278, 283 (D.C. Cir. 2006) (emphasis added). When confronted for the first time with an initial review case, the D.C. Circuit, like the Ninth Circuit, concluded that the terms of a contract limiting FERC review can be given effect only after FERC has had an opportunity for review of the contract, rejecting the proposition that "parties may, by mutual agreement, limit FERC's authority under Section 205 over initial review of a rate." *Id.* at 285-86.

The D.C. Circuit has limited the reach of language it has recognized as potentially overbroad in some older cases relied upon by petitioners. For example, in *PEPCO v. FERC,* commenting on earlier language (in a case involving an already-*reviewed* contract) that the presumption of legality of a contract rate is "practically insurmountable," the D.C. Circuit explicitly adopted

FERC's reasoning that to "apply[] the 'practically insurmountable' standard in *first review* cases would mean that FERC's ability to protect the public interest would be negligible and public regulation would consist of little more than rubber-stamping private contracts." 210 F.3d 403, 409 (D.C. Cir. 2000) (emphasis added). The D.C. Circuit has likewise made clear a crucial premise of *Mobile-Sierra*: "As we have held, the purpose of the *Mobile-Sierra* doctrine is to preserve the benefits of the parties' bargain as reflected in the contract, *assuming there was no reason to question what transpired at the contract formation stage.*" *Atlantic City Elec. Co. v. FERC,* 295 F.3d 1, 14 (D.C. Cir. 2002) (emphasis added); *accord, Town of Norwood v. FERC,* 587 F.2d 1306, 1312 (D.C. Cir. 1978) ("*when there is no reason to question what occurred at the contract formation stage,* the parties may be required to live with their bargains") (emphasis added). D.C. Circuit law thus shares the central tenets of the Ninth Circuit's rulings here.

In the important *TAPS* decision, the D.C. Circuit relied on these principles to *approve FERC's determination to allow customers to modify certain wholesale electricity contracts* that were tainted by market power because it would be contrary to the "public interest" to "let all contracts run their course with no opportunity for customers to modify or terminate their contracts, no matter how long the contracts or how onerous their terms." Order No. 888-A, 62 Fed. Reg. 12,274, 12,285 (March 14, 1997), *aff'd, TAPS,* 225 F.3d at 712. The D.C. Circuit likewise approved FERC's reformation of contracts affected by market dysfunctions in the natural gas industry. *United Distributors Cos. v. FERC,* 88 F.3d 1105, 1131 (D.C. Cir. 1996).

As to what *Mobile-Sierra* means when it applies, the D.C. Circuit has never insisted that the *Sierra* low-rate factors exhaust the inquiry in high-rate cases. The D.C. Circuit has spoken, more broadly, of the demand for "supportable and reasonable explanations for how the public interest required modification of private contracts." *Texaco Inc. v. FERC,* 148 F.3d 1091, 1097 (D.C. Circuit 1998). Despite petitioners' claims (MSCG Pet. 24, Dynegy Pet. 22), *PEPCO* is not to the contrary. The court there concluded that the petitioner "fail[ed] to provide any evidence of undue discrimination or excessive burden" and provided nothing more than "mere speculation" that electric consumers would be harmed by the FERC-approved contract at issue. 210 F.3d at 409. The record here, by contrast, contains vast evidence of market power, market dysfunction, violation of market rules, and direct impacts on electric consumers. Nothing in the D.C. Circuit's decision in *PEPCO*, or elsewhere, conflicts with the Ninth Circuit's ruling that FERC must now consider that evidence.

Nor is there merit to petitioners' claim (Dynegy Pet. 25) that the D.C. Circuit's decision in *Pub. Serv. Comm'n of New York v. FPC,* 543 F.2d 757 (D.C. Cir. 1974), conflicts with the Ninth Circuit's application of the just and reasonable standard. There the D.C. Circuit actually *approved* the FPC's abrogation of the contractual rate of 23.9 cents per thousand cubic feet of gas, in favor of the lower 18.5 cent rate FPC had earlier approved as just and reasonable in "area rate" proceedings. In *reducing* the rate, the D.C. Circuit "perceive[d] no impingement upon the *Mobile-Sierra* doctrine." *Id.* at 795. At the same time, the D.C. Circuit rejected, on *Mobile-Sierra* grounds, the FPC's attempt to eliminate the $134 million contractual cap on the pipeline's payments to the regulated producers and to replace it with a payment formula that would have substantially *increased* payments to the producers. *Id.* at 795-96. The D.C. Circuit's statement that FERC is "no more at liberty to alter" contracts "to the prejudice of the producers than to do so in their favor" was made in the context of a contract between natural gas producers and pipelines, with no clear implication for ultimate gas consumers. *Id.* at 798.

Petitioners also claim (Calpine Pet. 12; Dynegy Pet. 16; Sempra Pet. 16-17) that the Ninth Circuit's decisions are inconsistent with *Borough of Lansdale v. FPC,* 494 F.2d 1104, 1112-14 (D.C. Cir. 1974), and related D.C. Circuit cases.[10] But those cases addressed whether a seller can unilaterally force a buyer to accept a new, higher-rate contract when the seller failed to comply with its obligations to file the original contract. The Ninth Circuit correctly concluded that "*Lansdale's* position that a seller may not profit by failing properly to file a rate-setting contract it freely entered into is hardly remarkable, but is also not particularly pertinent to the questions at issue here." Pet. App. 40a.[11]

B. The First Circuit

The Ninth Circuit's construction of *Mobile-Sierra* does not conflict with First Circuit decisions. Petitioners claim (Dynegy Pet. 24) that *Boston Edison Co.* requires application of the "public interest" standard in this case. But unlike the contracts at issue here, the contracts reviewed in *Boston Edison* had already been accepted for filing by FERC (233 F.3d at 69) – as also was true in *Boston Edison Co. v. FERC,* 856 F.2d 361, 371-72 (1st Cir. 1988). FERC had the opportunity to determine whether the contracts were just and reasonable in the first instance, which it did not have here.

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[10] *Compania de Gas de Nuevo Laredo v. FERC,* 606 F.2d 1024, 1028-30 (D.C. Cir. 1979); *Sam Rayburn Dam Elec. Coop. v. FPC,* 515 F.2d 998, 1008-10 (D.C. Cir. 1975).

[11] Petitioners (Dynegy Pet. 16) cite only one case outside the First and D.C. Circuits to support their claims of circuit conflicts – a case decided fifty years ago in the Fifth Circuit, *Natural Gas Pipeline Co. v. Harrington,* 246 F.2d 915, 919 (5th Cir. 1957). But that case addressed the same issue as the D.C. Circuit's *Lansdale* decision and is irrelevant for the same reasons.

Petitioners also claim (MSCG Pet. 24) that the First Circuit requires contracts to be analyzed under the *Mobile-Sierra* factors developed for "low-rate" cases even where the Commission is considering a challenge to a contract rate that is too high. In fact, the First Circuit, upholding FERC's most thorough explication of the *Mobile-Sierra* doctrine to date, has held exactly the opposite:

> The holding of *Sierra* is clear; what justifies protective action in the public interest by the Commission *when it is considering whether a contract rate is too low* is whether the rate might impair the financial ability of the utility to continue to supply electricity, force electricity consumers to bear an excessive burden, or be unduly discriminatory. This definition of what is necessary in the public interest was formulated in the context of a *low-rate case.* It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases.

Northeast Utils. v. FERC, 55 F.3d 686, 690 (1st Cir. 1995) (emphasis added), *aff'ing Northeast Utils. Serv. Co.*, 66 FERC ¶ 61,332, p. 62,081-88 (1994).

Petitioners also rely (Dynegy Pet. 19-20) on *dictum* from *Northeast Utilities Service Co. v. FERC,* 993 F.2d 937, 961 (1st Cir. 1993), suggesting that a "case-by-case" analysis of market power in the context of *Mobile-*

Sierra might unnecessarily inject a "time-consuming element" into FERC's "public interest" review, requiring a "fuller explanation from the Commission . . before proceeding down this route." *Id.* at 961. But nothing in the Ninth Circuit's decisions requires a "case-by-case" analysis of market power or dysfunction, Pet. App. 11a (FERC "must find *another method* of evaluating whether the challenged rates are just and reasonable" besides simple abdication of its statutory duty (emphasis added)), and FERC has already rejected the assertion that it does. *Californians for Renewable Energy, Inc. v. California PUC*, 119 FERC ¶ 61,058, ¶ 1 (2007) ("*CARE*").

Petitioners also claim (Dynegy Pet. 25-26) that the Ninth Circuit's decisions conflict with the First Circuit's suggestion in *Northeast Utilities* that FERC cannot apply a "just and reasonable" analysis to alter a contract containing *Mobile-Sierra* language. *Northeast Utils.*, 993 F.2d at 961. There is no conflict. Petitioners' point is only about a difference in terminology – the First Circuit suggested that "public interest" *displaces* the statutory "just and reasonable" requirement, a position petitioners have rightly disowned, *see* note 6, *supra* – and not of substance: the circuits' ruling on this issue do not conflict over the substantive standards applicable to contracts covered by *Mobile* and *Sierra*.

The Ninth Circuit reasoned (Pet. App. 63a-65a) that the "public interest" protected by the FPA is implicated when electric consumers suffer from artificially inflated rates due to wholesale electric contract rates driven *above* the "zone of reasonableness" by market dysfunction, and that FERC's "excessive burden" test was contrary to the statute because it failed even to consider that harm. Expressly recognizing that FERC must weigh the public interest in the stability of contracts, the Ninth Circuit did not equate Commission authority over contract rates subject to *Mobile-Sierra* with Commission authority over rates that are not part of a contract subject to *Mobile-Sierra*. For its part, the First Circuit recognized that "[t]he *Mobile-Sierra* doctrine itself allows for intervention by FERC where it is shown that the interests of third parties are threatened . . . *notably the buyer's customers*." *Northeast Utils.*, 993 F.2d at 961 (emphasis added). And it subsequently approved FERC's rejection of a contract clause that *potentially* threatened electric consumers with open-ended rate increases. *Northeast Utils.*, 55 F.3d at 691-93. The Ninth Circuit's conclusion that large *actual* rate increases arising from documented market dysfunction may violate the public interest is therefore fully consistent with First Circuit precedent.

III. The Decisions Below Give FERC Ample Authority To Rely On Market-Based Rates.

Petitioners predict doom for FERC's market-based rate reforms and for investment in the industry. But nothing in the Ninth Circuit's decisions will cause the hypothesized harms. Indeed, the FERC program that the Ninth Circuit found faulty has already been modified by FERC in significant ways it deems to improve protection of consumers and to strengthen investment.

To begin with, nothing in the Ninth Circuit's opinions challenges FERC's authority to rely on market-based rates. Indeed, although neither the Western Utilities nor the Nevada BCP raised any such challenge, the Ninth Circuit explicitly concluded that FERC *may* rely on market-based rates so long as it maintains safeguards to ensure that the markets function properly. Pet. App. 47a.

Nor is there any basis for petitioners' argument that the Ninth Circuit's decisions allow buyers to escape contracts simply because they become dissatisfied with their bargain.[12] To the contrary, the Ninth Circuit explicitly rejected the proposition that "*any* direct impact on consumer rates is enough" to justify contract reformation and recognized that "normal market forces" may cause brief spikes in rates. Pet. App. 64a (emphasis in original). Accordingly, the Ninth Circuit's decisions do not open energy contracts to generalized attack. In fact, FERC has itself recently concluded that the Ninth Circuit did nothing to invalidate the Commission's market-based rate program. *CARE,* 119 FERC at ¶¶ 1, 45. Nor do the decisions undermine proper investment incentives, since sellers may retain profits that would be produced in properly functioning markets. The Ninth Circuit has merely required FERC to have an effective mechanism in place for situations, like the 2000-2001 western energy crisis, when markets fail to maintain rates at just and reasonable levels.

In fact, the record contains substantial evidence that investment is strongest in well-regulated markets, and that the radical form of deregulation advocated by petitioners would actually harm investment, as well as overall economic performance. Evidence submitted by the Western Utilities demonstrates, for example, that reform of the contracts arising from dysfunctional markets is necessary to ensure the proper functioning of those markets, ER 1028-29, 1082-84; to prevent a perverse and wasteful roller-coaster pattern of investment in the industry, ER 892, 1050-51, 1084; to avoid "merely perpetuat[ing]" the economic dislocation caused by the market dysfunction, which resulted in "the loss of tens of thousands of jobs and huge losses in productivity across the region," ER 1051; and to prevent the collapse of FERC's primary policy goal, market-based reform in the electric industry, ER 1084-86. Indeed, ten of the nation's leading academic economists – including Dr. Alfred Kahn, the intellectual pioneer of the deregulation movement – advised FERC in the midst of the crisis that "temporary market interventions" were needed to ensure just and reasonable rates and warned that FERC's failure to act could "setback, potentially fatally, the diffusion of competitive electricity markets across the country." ER 896-98.

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[12] In advancing this claim, MSCG (Pet. 8) relies on FERC counsel's arguments concerning "sanctity of contracts" and the ALJ's erroneous claim that the MSCG contract somehow "resulted in rate relief" for Snohomish's ratepayers. Neither claim was ever made by the Commission, however, and therefore its decision cannot be upheld on those bases.

Petitioners cite but two examples to support their prediction of a flood of litigation challenging market-based contracts. FERC disposed of the first, *CARE,* by summary dismissal. The second is a recently filed complaint by the Illinois Attorney General alleging that suppliers bidding into the auction used by Illinois to provide power for the bulk of its retail consumers engaged in market manipulation and manipulation of the auction process, resulting in rates far outside the zone of reasonableness. *See* Amended Complaint, *Madigan v. Exelon Generation Co. et al.,* FERC Docket No. EL07-47-000 (filed March 15, 2007). FERC has yet to take any action on this complaint, but petitioners' claim that FERC is without authority to address such serious allegations of wrongdoing only underscores that the Ninth Circuit was correct in rejecting their position. And these two complaints hardly constitute the flood of litigation predicted by petitioners.

Those predictions are further discredited by the substantial changes to the regulatory system that have occurred in the years since the western crisis ended in 2001, which were implemented to "prevent a repeat of the California 2000-2001 energy crisis." *CARE*, 119 FERC at ¶ 31. As FERC has concluded, the relevant regulatory regime has "undergone substantial improvements since 2001." *Id.* at ¶ 29. *Accord* Order No. 697, *Market-Based Rates*, 72 Fed. Reg. 35,903, 39,906-07 (July 20, 2007). Specifically, Congress in 2005 added significant new regulatory tools to FERC's arsenal designed to prevent a recurrence of the market manipulation that characterized the 2000-2001 crisis. *CARE*, 119 FERC at ¶¶ 33-35 (describing changes to FPA and FERC rulemakings to implement those changes). In addition, FERC itself has substantially strengthened the lax market oversight that contributed greatly to the 2000-2001 crisis.[13]

For example, FERC has both tightened its requirements for granting market-based rate authority to sellers and improved monitoring of conduct and policing of violations. *Id.* at ¶¶ 31-32, 35-39 (describing FERC reform measures). Recently (June 21, 2007), FERC adopted final rules "clarifying and further improving its market-based rate program." Order No. 697, 119 FERC ¶ 61,295 (2007). FERC's Chairman noted that FERC's current market-based rates program "bears little resemblance to the program the [Ninth Circuit] criticized." Statement of Chairman Kelliher, *available at* http://www.ferc.gov/news/statements-speeches/kelliher/2007/06-21-07-kelliher-E-1.pdf. FERC has also initiated a rulemaking to further improve the operation of "organized" markets such as those in California. *Wholesale Competition,* 72 Fed. Reg. 36,275 (July 2, 2007). This Court should not review decisions about a regulatory program that already has changed considerably, particularly when FERC itself views the changes as improvements.

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[13] California also has implemented extensive changes to its electric markets designed to prevent a repeat of the 2000-2001 crisis. *Id.* at ¶ 31 & n.27 (describing FERC approval of extensive changes to California's market design).

Finally, these cases are in an interlocutory posture, and petitioners may present their policy arguments to FERC on remand. It is at a minimum premature to conclude that FERC cannot avoid untoward consequences of the sort petitioners allege will flow from the Ninth Circuit's decisions.

CONCLUSION

The petitions for writs of certiorari should be denied.

Respectfully submitted.

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Nos. 06-1454, 06-1457, 06-1462 and 06- 1468 8-6-07

In the Supreme Court of the United States

SEMPRA GENERATION, ET AL., PETITIONERS

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.

MORGAN STANLEY CAPITAL GROUP INC., PETITIONER

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

CALPINE ENERGY SERVICES, L.P., ET AL., PETITIONERS

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

DYNEGY POWER MARKETING, INC., ET AL., PETITIONERS

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether, under *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), the Federal Energy Regulatory Commission may take into account the severe market dysfunction of the 2000-2001 western energy crisis in determining the standard to be applied in its review of contracts for the sale of electric power.

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In the Supreme Court of the United States

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v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.

No. 06-1457

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v.

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No. 06-1462

CALPINE ENERGY SERVICES, L.P., ET AL., PETITIONERS

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

No. 06-1468

DYNEGY POWER MARKETING, INC., ET AL., PETITIONERS

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinions of the court of appeals (Pet. App. 1a-15a, 268a-329a) are reported at 474 F.3d 587 and 471 F.3d 1053.[1] The orders of the Federal Energy Regulatory Commission (Pet. App. 91a-214a, 215a-267a; 06-1462 Pet. App. 246a-313a, 314a-363a) are reported at 103 F.E.R.C. ¶ 61,354, 105 F.E.R.C. ¶ 61,182, 103 F.E.R.C. ¶ 61,353, and 105 F.E.R.C. ¶ 61,185.

JURISDICTION

The judgments of the court of appeals were entered on December 19, 2006. On March 6 and March 8, 2007, Justice Kennedy extended the time within which to file petitions for a writ of certiorari to and including May 3, 2007, and the petitions were filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Federal Power Act (FPA), 16 U.S.C. 791a *et seq.*, grants the Federal Energy Regulatory Commission (Commission or FERC) exclusive jurisdiction over the "transmission of electric energy in interstate commerce" and the "sale of electric energy at wholesale in interstate commerce." 16 U.S.C. 824(b)(1). Proposed rates for the sale or transmission of power within FERC's jurisdiction are subject to FERC review to ensure that they are "just and reasonable" and not unduly discriminatory or preferential. 16 U.S.C. 824d(a) and (b). To that end, the FPA provides that, "[u]nder such

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[1] Unless otherwise noted, all references to "Pet." and "Pet. App." are to the petition and appendix in No. 06-1454.

rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, * * * schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission." 16 U.S.C. 824d(c).

2. Until the 1980s, the Commission established rates primarily on a cost-of-service basis. As barriers to entry in the generation sector declined, however, a competitive market for wholesale sales of electric energy began to emerge. In response to that development, the Commission began considering and approving market-based rates for wholesale electric energy sales in the late 1980s.

Under the Commission's market-based rate program, the Commission approves a seller's request to sell electric energy at market-based rates only if it first finds that the seller and its affiliates either do not have market power or have adequately mitigated their market power. See *California ex rel. Lockyer* v. *FERC*, 383 F.3d 1006, 1009 (9th Cir. 2004), cert. denied, 127 S. Ct. 2972 (2007) (*Lockyer*). Specifically, the Commission undertakes an intensive factual review of the relevant product and geographic markets to determine whether, based on an analysis of market concentration during various seasons and load levels, the seller has market power. See *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity & Ancillary Servs. by Pub. Utils.*, 115 F.E.R.C. ¶ 61,210 (2006); *AEP Power Mktg., Inc.*, 107 F.E.R.C. ¶ 61,018, on reh'g, 108 F.E.R.C. ¶ 61,026 (2004). Market power is defined as a seller's ability to "'significantly influence price in the market by withholding service and excluding competitors for a significant period of time.'" *Lockyer*, 383 F.3d at 1012 n.4 (quoting *Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210, at 61,777 (1989)).

The Commission's review is designed to assure a competitive market, because "when there is a competitive market the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a 'just and reasonable' result." *Elizabethtown Gas Co.* v. *FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993); see *Lockyer*, 383 F.3d at 1013 (noting that "[i]n a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable") (quoting *Tejas Power Corp.* v. *FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990)).

To assure that the Commission can monitor, on a continuing basis, the justness and reasonableness of market-based rates and the potential exercise of market power, the Commission also imposes an ongoing quarterly reporting requirement for market transactions. See *Lockyer*, 383 F.3d at 1013. The quarterly reporting requirement provides a means for the Commission and the public to identify pricing trends or discriminatory patterns that might suggest the exercise of market power. See *California ex rel. Lockyer*, 99 F.E.R.C. ¶ 61,247, at 62,063, reh'g denied, 100 F.E.R.C. ¶ 61,295 (2002). For each contract, sellers are required to report the buyer's and seller's name, a description of the service, the delivery point for the service, the price, "the quantities to be served or purchased; the contract's duration . . . and any other attributes of the product being purchased or sold which contribute to its market value."

Lockyer, 99 F.E.R.C. at 62,066 (quoting *Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210, at 61,778 (1989)).

"After-the-fact reporting allows the market to operate initially without regulatory intrusion," avoiding the costs and practical difficulties that would be associated with prior review of a large number of transactions, many of which are of short duration. *Lockyer*, 99 F.E.R.C. at 62,065. At the same time, the reporting requirement provides the Commission with information with which it can monitor and oversee the rates being charged, and it places sellers on notice that their authorization to sell at market-based rates will be subject to continuing review and, if necessary, to remedial action, including the possible revocation of that authorization. *Ibid.* Further, upon finding a tariff violation, the Commission may take retroactive action, including ordering the disgorgement of unjust profits. *California ex rel. Lockyer* v. *British Columbia Power Exch.*, 100 F.E.R.C. ¶ 61,295, at 62,334 (2002).

3. In 1995, in response to retail electric rates that were well above the national average, California comprehensively restructured the electric energy industry in that State. At that time, the major traditional investor-owned utilities were vertically integrated; that is, they owned generating resources, transmission lines, and distribution facilities. *Lockyer*, 383 F.3d at 1008-1009 & n.2. Under the restructuring, those utilities were required to divest most of their generating assets and to purchase power at market-based rates through an independent power exchange, which operated an organized wholesale market, and an independent system operator, which managed the transmission network.

As part of California's restructuring plan, California's three major investor-owned utilities filed applications with FERC seeking authority to sell electric energy at wholesale at market-based rates. In accordance with its established policy, FERC approved their requests for market-based rate authority after finding that the companies and their affiliates either did not have, or had adequately mitigated, market power. See, *e.g.*, *Pacific Gas & Elec. Co.*, 81 F.E.R.C. ¶ 61,122, at 61,437, 61,537, 61,572 (1997), aff'd, 82 F.E.R.C. ¶ 61,223 (1998). FERC also reviewed and approved applications by other wholesale generators and suppliers that lacked, or had adequately mitigated, market power to sell electric energy at market-based rates in the California markets. See, *e.g.*, *Lockyer*, 99 F.E.R.C. at 62,055.

For two years, the restructured California electricity markets operated largely as intended. Starting in the summer of 2000, however, wholesale electricity prices in California increased significantly, with the day-ahead market peaking at a 15-fold increase over the pre-restructuring average cost. See *In re Cal. Power Exch. Corp.*, 245 F.3d 1110, 1115 n.2 (9th Cir. 2001). As a result, load-serving utilities incurred billions of dollars of debt, and the independent system operator declared dozens of system emergencies and occasional rolling blackouts. *Id.* at 1115-1116.

Acting in response to a complaint filed on August 2, 2000, FERC took steps to remedy the situation. Specifically, it implemented structural and pricing reforms to make California and western electricity markets more stable and less susceptible to price spikes. See, *e.g.*, *California Power Exch.*, 245 F.3d at 1114-1116; *San Diego Gas & Elec. Co.* v. *Sellers of Energy & Ancillary Servs.*, 93 F.E.R.C. ¶ 61,294, at 61,982 (2000). The Commission also urged the California utilities to enter into long-term contracts, finding that a key structural flaw of the California market was the State's decision to place primary reliance on spot-market purchases. As a result of these steps and other factors, by early June 2001, prices in California spot and forward markets fell back to preexisting competitive levels. See *San Diego Gas & Elec. Co.* v. *Sellers of Energy & Ancillary Servs.*, 95 F.E.R.C. ¶ 61,418, at 62,546 (2001).

4. The western energy crisis generated considerable litigation. In an earlier proceeding, the Court of Appeals for the Ninth Circuit reviewed a broad challenge to the Commission's market-based rate program, in which some parties argued that any market-based rate contract must actually be filed with the Commission for it to be effective. See *Lockyer*, 383 F.3d at 1011-1013. The court of appeals rejected that challenge, holding that "the dual requirement of an ex ante finding of the absence of market power *and* sufficient post-approval reporting requirements" are sufficient to satisfy the notice and filing requirements of the FPA. *Id.* at 1013. But the court found that "non-compliance with FERC's reporting requirements was rampant" during the western energy crisis, and it therefore remanded the case to the Commission to consider whether such noncompliance was sufficient to merit refunds to the purchasers under those contracts. See *id.* at 1014. This Court denied certiorari. See *Coral Power, L.L.C.* v. *California ex rel. Brown*, 127 S. Ct. 2972 (2007) (No. 06-888).

5. The proceedings below concerned challenges to specific long-term contracts entered into during the 2000-2001 western energy crisis. The purchasers filed

complaints with FERC, arguing that the contracts should be reformed because they were tainted by market power or dysfunction. The Commission denied the complaints. Pet. App. 91a-214a; 06-1462 Pet. App. 246a-313a.

The Commission's orders cited this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (*Mobile*), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*). Pet. App. 93a; 06-1462 Pet. App. 90a-91a. In *Mobile*, the Court interpreted provisions of the Natural Gas Act that parallel the FPA, and it held that the statute "preserv[es] the integrity of contracts" and does not permit companies unilaterally to change those contracts. 350 U.S. at 344. The same day, the Court held in *Sierra* that the Federal Power Commission could not declare a rate set by contract to be "unreasonable solely because it yields less than a fair return on the net invested capital." *Id.* at 355. Rather, "the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest." *Ibid.* The *Mobile-Sierra* doctrine, grounded in those two decisions, rests on the assumption that "[i]n wholesale markets, the party charging the rate and the party charged were often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon Commc'ns Inc.* v. *FCC*, 535 U.S. 467, 479 (2002).

Applying *Mobile-Sierra*, the Commission concluded that the appropriate standard of review for the contracts at issue in this case was the "public interest" standard rather than the ordinary "just and reasonable" standard. Pet. App. 93a; 06-1462 Pet. App. 248a-249a. Since the purchasers had not shown that the contracts were contrary to the public interest, the Commission denied the complaints. Pet. App. 95a-96a; 06-1462 Pet. App. 248a.

6. The purchasers petitioned for review. In a pair of decisions issued the same day, the court of appeals granted the petitions and remanded the cases to FERC for further proceedings. Pet. App. 1a-15a, 268a-329a.

The court of appeals stated that "there is but one statutory standard addressing the lawfulness of wholesale electricity rates," and "[t]hat standard requires that *all* rates be 'just and reasonable.'" Pet. App. 300a. The *Mobile-Sierra* doctrine, the court reasoned, is simply "one means of review under the just and reasonable standard, applicable in certain limited circumstances." *Ibid.* Specifically, the court concluded that *Mobile-Sierra* applies when three conditions are met: (1) the terms of the contract must not preclude its application, *id.* at 301a; (2) "the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for initial review of the contracted rate," *id.* at 303a; and (3) "the scope of that review must permit consideration of the factors relevant to the propriety of the contract's formation," *id.* at 305a. See *id.* at 9a.

The court of appeals concluded that FERC erred in its application of the *Mobile-Sierra* doctrine to the contracts at issue in these cases. The court agreed with the Commission that the contracts did not preclude the application of *Mobile-Sierra*. Pet. App. 306a-309a. But it held that FERC did not have an opportunity for timely and effective review of rates. While acknowledging that "market-based rate authority *can* qualify as sufficient prior review to justify limited *Mobile-Sierra* review," the court stated that market-based rates must be "accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change." *Id.* at 309a-310a. As in *Lockyer*, the court believed that the Commission failed appropriately to oversee market-based rates during the western energy crisis. *Id.* at 319a. In the court's view, quarterly reporting was "unlikely to expose in a timely manner the impact of market changes," and it allowed "review of the grounds for market-based rate authority only with regard to contracts entered into *after* the impact of the market dysfunction or market power on long-term bilateral contracts has already occurred." *Id.* at 315a.

Added to that "procedural error" was the Commission's "substantive adherence to *Mobile-Sierra* without regard to the market conditions in which the contracts at issue were formed." Pet. App. 320a. "*Mobile-Sierra* cannot apply," the court of appeals reasoned, "without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." *Ibid.* The court found that FERC had failed to consider evidence that "the dysfunction and manipulation of the spot market[] artificially influenced the rates in the forward market," *id.* at 321a, notwithstanding the conclusion of a FERC staff report that "forward power prices negotiated during 2000-2001 in the western United States were *significantly influenced* by the then-current spot power prices," *id.* at 320a (quoting FERC Staff, *Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation* *of Electric and Natural Gas Prices* ES-12 (2003) (*Staff Report*)) <www.ferc.gov/legal/maj-ord-reg/land-docs/PART-I-3-26-03.pdf>.

The court went on to state that, even if the *Mobile-Sierra* doctrine applied, the Commission had used "an erroneous standard for determining whether the challenged contracts affect the public interest." Pet. App. 322a-323a. Specifically, the court concluded that FERC had erroneously applied "factors taken from the context of a *low-rate* challenge rather than those relevant to the *high-rate* challenge present in this case." *Id.* at 323a. FERC should instead have considered whether the contracts were "outside the 'zone of reasonableness' and result[ed] in retail rates higher than would be the case if that zone were not exceeded." *Id.* at 327a.

The court remanded to the Commission "to determine, first, whether *Mobile-Sierra* review of the challenged contracts is appropriate; second, if so, to apply the modified form of *Mobile-Sierra* review outlined in this opinion; and finally, if not, to apply full just and reasonable review to the challenged contracts." Pet. App. 328a; see *id.* at 15a.

ARGUMENT

Petitioners argue (06-1457 Pet. 15) that the decisions of the court of appeals are contrary to settled precedent, placing *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), "in the historical dustbin." Petitioners greatly overstate the breadth of the opinions below. The opinions do not overturn long-term power contracts. Instead, they remand to the Commission for further factual inquiry. The opinions do not hold that *Mobile-Sierra* protections are unavailable to market-based rate contracts unless they are first reviewed by the Commission. Instead, they hold that market-based rate authority qualifies as sufficient prior rate review to justify *Mobile-Sierra* contract review, so long as it is accompanied by continuing and effective oversight of the market. And the opinions do not overturn the *Mobile-Sierra* doctrine. Instead, they apply the principles of *Mobile* and *Sierra* to the highly unusual context of the 2000-2001 western energy crisis, the worst electricity-market crisis in American history. The decisions below stand for the narrow proposition that, if there is a credible claim that severe market dysfunction has affected the formation of a market-based contract, the Commission must take that fact into account in determining whether the public-interest standard of *Mobile-Sierra* applies to its review of that contract.

Taken as a whole, the decisions of the court of appeals allow the Commission sufficient discretion on remand to consider all relevant factors in determining whether the contracts at issue should be upheld or reformed. Allowing the Commission to address these issues on remand will not "cause severe damage to the wholesale energy markets." 06-1457 Pet. 25. The decisions have not, as petitioners suggest, caused a flood of complaints by disgruntled purchasers seeking to reform contracts. In fact, there have been relatively few complaints, and, more important, the Commission has promptly rejected those that lack merit. See, *e.g.*, *Californians for Renewable Energy, Inc.* v. *California Pub. Utils. Comm'n*, 119 F.E.R.C. ¶ 61,058 (2007) (*CARE*).

Petitioners allege various conflicts between the decisions below and the decisions of this Court and other courts of appeals, but their arguments ignore the unique nature of the western energy crisis of 2000-2001. None of the cases on which they rely addressed a remotely similar event. As FERC applies the decisions below to future contracts—not affected by the unprecedented market dysfunction of the 2000-2001 crisis—there is no reason to suppose that it will reach conclusions different from those that it would reach if it were to apply the decisions of other courts of appeals. Further review is not warranted.

1. Petitioners contend (Pet. 15-17, 20; 06-1457 Pet. 17; 06-1462 Pet. 11-13; 06-1468 Pet. 14-17) that the court of appeals limited the application of the *Mobile-Sierra* doctrine to instances in which FERC reviews the terms of a contract before it takes effect. In their view, the decision below has effectively eliminated *Mobile-Sierra* protections in the context of market-based rates, making market-based rate approval a useless exercise. Petitioners misinterpret the court's opinions.

As petitioners point out, the court of appeals stated that "the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for initial review of the contracted rate." Pet. App. 303a. But the court also took pains to emphasize, as it had two years earlier in *Lockyer*, that in "the contemporary regulatory regime," the requisite initial review "can be limited to review of a utility's market-based rate authority in the first instance." *Id.* at 302a; see *id.* at 309a-310a (noting that "market-based rate authority *can* qualify as sufficient prior review to justify limited *Mobile-Sierra* review," so long as it is "accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change"); *id.* at 311a-312a; see also *Lockyer*, 383 F.3d at 1013. Thus, the court did not hold that the filing of a contract with the Commission is a necessary prerequisite to the application of *Mobile-Sierra*.[2] Instead, the court of appeals remanded for two narrower reasons, neither of which merits further review.

a. First, the court held that the Commission did not adequately oversee the market after granting petitioners' market-based rate authority during the western energy crisis. Pet. App. 314a-320a. That finding is primarily of historical interest, given that the oversight regime that exists today is far different from that which existed in 2000-2001.

Since the western energy crisis, and in no small part because of it, the Commission has created a new Office of Enforcement to oversee markets and enforce compliance with its orders and regulations; it has increased the transparency of market information to enhance its oversight function; it has reformed California electricity markets to correct the design flaws that contributed to the crisis; and it has adopted a more rigorous market power analysis in reviewing market-based rate requests and has imposed additional requirements, including change-in-status filing requirements, as a condition of retaining market-based rate authority.[3] In addition, Congress has enacted legislation giving the Commission authority to punish market manipulation and impose civil penalties for market rule violations. See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1283, 119 Stat. 979 (to be codified at 16 U.S.C. 824v (Supp. V 2005)) (authorizing FERC to prohibit "any manipulative or deceptive device or contrivance" by "any entity" in connection with a FERC-jurisdictional transaction); § 1284, 119 Stat. 980 (to be codified at 16 U.S.C. 825o-1 (Supp. V 2005)) (providing for enhanced civil penalties for willful violations of Part II of the FPA).

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[2] Petitioners cite numerous cases in which other circuits have held that *Mobile-Sierra* applies to contracts not filed with the Commission. See 06-1462 Pet. 11-13; 06-1468 Pet. 16-17; Pet. 16-17. Because the court of appeals in this case did not hold that such filing is required for to the application of *Mobile-Sierra*, there is no conflict.

Petitioner Dynegy notes (06-1468 Pet. 17-18) that it *did* file its contract with the Commission. The court of appeals did not consider that fact to be dispositive, because, "[a]t the time Dynegy filed its contract, the full scale of market manipulation and forward market dysfunction was not nearly as fully known as it is today." Pet. App. 11a. In other words, the result in Dynegy's case rested on the court's holding that market dysfunction is relevant to determining whether to apply the *Mobile-Sierra* public-interest test. For the reasons discussed at pp. 16-18, *infra*, that holding does not warrant review.

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[3] See generally *CARE*, 119 F.E.R.C. ¶ 61,058 paras. 31-41 (describing steps taken by the Commission "to ensure that there are appropriate market safeguards in place to prevent a repeat of the California 2000-2001 energy crisis"); see also, *e.g.*, *Revised Pub. Util. Filing Requirements*, 99 F.E.R.C. ¶ 61,107 (2002) (Order No. 2001) (requiring electronic filing of quarterly reports providing transaction-specific data on wholesale power sales) (67 Fed. Reg. 31,044 (2002)), order on reh'g, 100 F.E.R.C. ¶ 61,074 (2002), order on reh'g, 100 F.E.R.C. ¶ 61,342 (2002); *Order Amending Market-Based Rate Tariffs & Authorizations*, 105 F.E.R.C. ¶ 61,218 (2003) (imposing market behavioral rules in all market-based rate tariffs), order on reh'g, 107 F.E.R.C. ¶ 61,175 (2004), petition for review denied, No. 04-1238, 2007 WL 1791011 (D.C. Cir. June 22, 2007); *Electric Quarterly Reports*, 105 F.E.R.C. ¶ 61,219 (2003) (revoking market-based rate authority for utilities that failed to meet reporting requirements); *Order Revoking Market-Based Rate Auth., Establishing Hearing & Settlement Judge Procedures, & Terminating Sec. 206 Proceeding*, 113 F.E.R.C. ¶ 61,124 (2005) (same); *AEP Power Mktg., Inc.*, 107 F.E.R.C. ¶ 61,018 (2004) (adopting new interim generation market-power analysis and mitigation policy), on reh'g, 108 F.E.R.C. ¶ 61,026 (2004); *Reporting Requirement for Changes in Status for Pub. Utils. with Market-Based Rate Auth.*, 110 F.E.R.C. ¶ 61,097 (Order No. 652) (amending regulations to establish a reporting obligation for changes in status that apply to public utilities authorized to make sales at market-based rates) (70 Fed. Reg. 8253 (2005)), reh'g granted in part, 111 F.E.R.C. ¶ 61,413 (2005); *Prohibition of Energy Mkt. Manipulation*, 114 F.E.R.C. ¶ 61,047 (2006) (Order No. 670) (amending Commission regulations to implement new Section 222 of the Federal Power Act, prohibiting the employment of manipulative or deceptive devices or contrivances) (71 Fed. Reg. 4244 (2006)). See also *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity, & Ancillary Servs. by Pub. Utils.*, 119 F.E.R.C. ¶ 61,295 (2007) (revising current standards for market-based rate sales); *Notice of Proposed Rulemaking*, 118 F.E.R.C. ¶ 61,031 (2007) (proposing revised standards of conduct for electric transmission providers) (72 Fed. Reg. 3958 (2007)).

The Commission has already recognized the relevance of these new measures to the evaluation of contracts under *Mobile-Sierra*. In an opinion issued subsequent to the Ninth Circuit's decision in this case, FERC explained that the decision below "addressed a unique set of facts and a market-based rate program that has undergone substantial improvements since 2001." *CARE*, 119 F.E.R.C. ¶ 61,058 para. 29. In light of those improvements in FERC's market oversight, when sellers "have been granted market-based rate authority, the wholesale contracts that they have entered into are presumed to be just and reasonable." *Id.* para. 42.

b. As an independent basis for its remand, the court of appeals held that the Commission erred in determining, as a matter of law, that market dysfunction is irrelevant to whether the public-interest standard applies. Pet. App. 320a. As the court noted, the Commission's staff had found that "forward power prices negotiated during 2000-2001 in the western United States were significantly influenced by then-current spot power prices," and "that the trauma of the dysfunctional spot power prices at that time so influenced buyers that they placed great weight on these prices in forming future expectations." *Staff Report* ES-9; Pet. App. 320a. But the Commission declined to consider that evidence in determining whether or not the public-interest standard governed its review of the contracts, choosing instead to consider it as one factor in deciding whether, applying the public-interest standard, the contracts should be modified. 06-1462 Pet. App. 292a-293a; Pet. App. 108a-109a. As the Commission saw it, to justify contract modification under the public-interest standard, it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot-market dysfunction; rather, it must be shown that the contract rates, terms, and conditions were contrary to the public interest. *Ibid.* The court of appeals found the Commission's approach erroneous, however, because the Commission failed "ever to consider whether the influence of the spot markets on the forward markets reached a level sufficient to question whether FERC could assume that two private parties had negotiated a 'just and reasonable' contract in the first instance and therefore apply the *Mobile-Sierra* presumption." Pet. App. 321a.

The court's conclusion does not warrant review at this time because it is unclear how its position differs, in practical effect, from that of the Commission. Although the court criticized the Commission's approach, it did not explain its alternative approach in any detail. It appears that the court contemplates a two-step analysis in which the Commission first considers whether market dysfunction was so severe as to undermine *Mobile-Sierra*'s presumption that contract prices reflect a fair bargain between a willing buyer and a willing seller. See Pet. App. 320a (application of *Mobile-Sierra* requires "a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation"). Once that test is applied, the court seems to contemplate an analysis of whether to uphold or reform the contract based on all relevant factors under either the public-interest standard, if applicable, or the just-and-reasonable standard. *Id.* at 322a-327a.

Because the court of appeals has not specified the required inquiry in any detail, it has not restricted the Commission's ability, on remand, to consider all relevant facts in its analysis. Petitioners argue (06-1457 Pet. 23) that spot-market dysfunction is irrelevant as a matter of law because it is just another "fact about the world" that purchasers consider when entering into forward contracts. While spot-market dysfunction may be a "fact about the world," it is a very important fact. Recognizing this, the Commission's orders below did not disregard the spot-market dysfunction; rather, the Commission considered it as part of the "totality of circumstances" in considering whether the contracts offended the public interest. 06-1462 Pet. App. 339a; Pet. App. 111a. Even though the Commission upheld the contracts, it never suggested that the spot-market dysfunction was irrelevant as a matter of law in determining whether the public-interest standard could be overcome. The court has simply directed the Commission to consider spot-market dysfunction at a different stage in its analysis, and it is far from clear that the difference will be outcome-determinative in this or any other case. Nor is it likely that market dysfunction of the kind that occurred in the 2000-2001 western energy crisis will occur in the future. See pp. 6, 12-13, *supra*.

Petitioners also suggest (06-1468 Pet. 19-20) that the decision below conflicts with *Northeast Utils. Serv. Co.* v. *FERC*, 993 F.2d 937, 961 (1993), in which the First Circuit held that market power is not relevant to the application of *Mobile-Sierra*. Although the First Circuit did express that view initially, on a subsequent appeal following its remand, the First Circuit noted that, while it previously "questioned the significance of the seller's market power and the lack of arms-length bargaining, it left open the possibility that these factors may so affect third parties as to warrant intervention even under the public interest standard." *Northeast Util. Serv. Co.* v. *FERC*, 55 F.3d 686, 691-692 (1st Cir. 1995) (*Northeast Utils.*) (citation omitted). On its second review of the case, the First Circuit affirmed the Commission's application of a "more flexible" public-interest review of the contract at issue because the Commission had explained why the disputed contractual terms might harm third parties. *Id.* at 692. That holding is consistent with the approach taken by the court of appeals in this case.

2. Petitioners also contend that the court of appeals improperly "collapses" the public-interest and the just-and-reasonable standards in a "high rate" case, that is, a case in which a purchaser challenges a rate as excessively high. Pet. 24-25; 06-1468 Pet. 25-26. Here, too, petitioners misread the court's opinions.

Petitioners focus on the court of appeals' statement that "the proper standard * * * is not whether the contracted rates pose an 'excessive burden' on consumers, but whether the wholesale energy contract is outside the 'zone of reasonableness' and results in retail rates higher than would be the case if that zone were not exceeded." Pet. App. 326a-327a. But the court of appeals expressly rejected the proposition "that *any* direct impact on consumer rates is enough to demonstrate a public interest effect sufficient to displace the countervailing *Mobile Sierra* concern with protecting the stability of contract." *Id.* at 326a. Instead, while noting that "a functioning marketplace will drive prices towards marginal cost, and therefore towards * * * a reasonable range," the court made clear that, "[e]ven if a particular rate exceeds marginal cost * * * it may still be within this reasonable range—or 'zone of reasonableness'—if that higher-than-cost-based price results from normal market forces and is part of a general trend toward rates that do reflect costs." *Ibid.* Thus, contracts entered into in a "functioning marketplace" do not offend the public interest simply because the rates are above traditional measures of cost. *Ibid.*

Petitioners argue (Pet. 26) that the court of appeals created a "heads I win, tails you lose" rule in which purchasers can "challenge any contracts that are no longer favorable to them," but sellers cannot. As explained above, the court's application of the public-interest test does not permit a party to challenge a contract simply because it is "no longer favorable." Indeed, even under the just-and-reasonable standard, a purchaser may not claim "buyer's remorse" and be excused from a long-term contract simply because market prices have fallen during the term of the contract. Rather, it must demonstrate that the relative benefits and burdens have been upset over the life of the contract. See, *e.g.*, *Pontook Operating Ltd. P'ship* v. *Public Serv. Comm'n*, 94 F.E.R.C. ¶ 61,144, at 61,552 (2001); *French Broad Elec. Membership Corp.* v. *Carolina Power & Light Co.*, 92

F.E.R.C. ¶ 61,283 (2000); *San Diego Gas & Elec. Co.* v. *Public Serv. Comm'n*, 95 F.E.R.C. ¶ 61,073 (2001).

Nor did the court create a rule that is biased against sellers. In many of the portions of its opinion cited by petitioners, the court was simply observing that the factual considerations in low-rate and high-rate cases differ, a point that is neither surprising nor new. For example, the potential insolvency of a seller is always a concern in a low-rate case. See, *e.g.*, *Sierra*, 350 U.S. at 355 (noting that a low rate "might impair the financial ability of the public utility to continue its service"). In contrast, in a high-rate case, a purchaser may be able to pass rates on to its customers without going bankrupt. As the First Circuit has held, the *Sierra* "definition of what is necessary in the public interest was formulated in the context of a *low-rate* case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases." *Northeast Utils.*, 55 F.3d at 690.

Contrary to petitioners' suggestion, the court of appeals also recognized the importance of contractual stability, even in high-rate cases. For example, in addition to acknowledging that a functioning marketplace can often produce high rates—and that such rates can be consistent with the public interest—the court made clear that "the stability of contract considerations that underlie the *Mobile-Sierra* doctrine do carry over to challenges by buyers rather than sellers." Pet. App. 325a.

In any event, this case is a poor vehicle for considering the application of the public-interest standard to a high-rate case. The court's interpretation of the public-interest standard was unnecessary to its decision, since it had already remanded the case because of the Commission's failure to consider adequately whether the public-interest standard applies at all. And on remand, the Commission will be able to consider the issue in a manner consistent with traditional *Mobile-Sierra* principles, obviating many of the concerns raised by petitioners. In fact, FERC has already demonstrated that, in applying the principles of the court's decisions, it will protect contractual stability. The Commission has explained that it "protects customers * * * by providing rate stability through the protection of sales contracts," and that its "improved market-based rate program provides the foundation to ensure that sellers and buyers can continue to rely on market-based rate contracts to provide price certainty." *CARE*, 119 F.E.R.C. ¶ 61,058 para. 40. At this point, then, any consideration by this Court would be premature because the Court's review would benefit from the better-developed record that would be produced by FERC's application in the first instance on remand of the principles set out by the court of appeals.

3. Petitioners allege numerous conflicts between the decisions below and various decisions of other courts of appeals (Pet. 26; 06-1457 Pet. 24; 06-1462 Pet. 13-14; 06-1468 Pet. 15-16), but they ignore the obvious point that no other case addressed facts even remotely similar to those at issue here. The western energy crisis was the worst in the Nation's history. It arose from an unprecedented confluence of "flawed market rules; inadequate addition of generating facilities in the preceding years; a drop in available hydropower due to drought conditions; a rupture of a major pipeline supplying natural gas into California; strong growth in the economy and in electricity demand; unusually high temperatures; an

increase in unplanned outages of extremely old generating facilities; and market manipulation." *CARE*, 119 F.E.R.C. ¶ 61,058 para. 30. Those factors combined "to place California and the entire West in an electricity crisis that had never before been experienced." *Ibid.* The resulting crisis was hardly comparable, as petitioners suggest (06-1457 Pet. 22), to "the change in prices * * * caused by the sudden availability of power from the Shasta dam" in *Sierra*.

In two of the decisions on which petitioners rely, the courts of appeals actually affirmed Commission decisions to *reform* a contract under *Mobile-Sierra*. In *Northeast Utilities*, the First Circuit considered a power contract that was potentially harmful to third parties. Despite the presence of a *Mobile-Sierra* clause, the Commission reformed the contract to remedy the potential harm, and the court upheld the Commission's decision. See 55 F.3d at 692. Likewise, in *Maine Public Utilities Commission* v. *FERC*, 454 F.3d 278 (2006), the D.C. Circuit addressed a proposal by New England's transmission owners to pull out of a regional market without adequate prior review by the Commission. Despite the presence of a *Mobile-Sierra* clause, the Commission reformed the contract to require a meaningful prior review by the Commission before the transmission owners could withdraw from the market, and the D.C. Circuit upheld the Commission's action. See *id.* at 284.

Other cases rejected challenges to contracts, but none of them involved facts similar to those here. In *Potomac Electric Power Co.* v. *FERC*, 210 F.3d 403 (2000), the D.C. Circuit addressed a claim by a purchaser that its transmission rate in its 1987 contracts had become unreasonable over time. The Commission rejected the complaint, and the court upheld the decision because the purchaser "presented no evidence" that the rates were "unduly discriminatory or excessively burdensome on [the purchaser's] ratepayers." *Id.* at 409. In *Boston Edison Co.* v. *FERC*, 233 F.3d 60 (2000), the First Circuit vacated and remanded Commission orders applying a just-and-reasonable standard to reduce a seller's return on equity. In remanding the case for application of the public-interest standard, the court noted that "[v]ery little useful precedent exists" addressing the question whether rates are "so high as to be contrary to the public interest." *Id.* at 68. And in *San Diego Gas & Electric Co.* v. *FERC*, 904 F.2d 727, 730 (1990), the D.C. Circuit affirmed Commission orders rejecting a buyer's argument that a contract should be modified based on after-the-fact market changes.

None of the cited cases concerned a market-based rate contract, much less one entered into during the Nation's worst power crisis. At most, they illustrate the Commission's longstanding commitment to contractual stability, a commitment that has not lessened in the wake of the decisions at issue here. See *CARE*, 119 F.E.R.C. ¶ 61,058 para. 40.

4. Petitioners present a number of arguments based upon the particular factual circumstances of their individual cases. For example, some of the contracts included recitations to the effect that the terms were "'just' and 'reasonable' within the meaning of the FPA" (Pet. 22-23); some involved purchasers who were power marketers, not merely retail providers (06-1462 Pet. 17-19); and some were agreed to by parties who were already aware of market dysfunction (06-1468 Pet. 22-23).

In one case, the seller alleged that the contract would result in a relatively modest increase in retail rates. 06-1457 Pet. 23-24. In another, the purchasers presented evidence to the court of appeals that they had failed to present to FERC. Pet. 29-30.

Petitioners may present those (and other) case-specific arguments on remand, and the Commission may take them into account in addressing whether each contract should be reformed. If petitioners are dissatisfied with the result on remand, they will be able to seek agency rehearing and judicial review. See 16 U.S.C. 825*l*(a)-(b). At present, the interlocutory nature of those issues makes this Court's review premature. See *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST 2007

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Nos. 06-1454, 06-1457, 06-1462 and 06-1468

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In The
Supreme Court of the United States

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SEMPRA GENERATION, *et al.*,

Petitioners,

v.

PUBLIC UTILITIES COMMISSION OF
THE STATE OF CALIFORNIA, *et al.*,

Respondents.

[Captions Continued On Inside Cover]

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**On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit**

◆

BRIEF IN OPPOSITION OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND CALIFORNIA ELECTRICITY OVERSIGHT BOARD

◆

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◆

MORGAN STANLEY CAPITAL GROUP INC.,

Petitioner,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF
SNOHOMISH COUNTY WASHINGTON, *et al.*,

Respondents.

◆

CALPINE ENERGY SERVICES, L.P., *et al.*,

Petitioners,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF
SNOHOMISH COUNTY WASHINGTON, *et al.*,

Respondents.

◆

DYNEGY POWER MARKETING, INC., *et al.*,

Petitioners,

v.

PUBLIC UTILITIES COMMISSION OF
THE STATE OF CALIFORNIA, *et al.*,

Respondents.

◆

PARTIES TO THE PROCEEDINGS BELOW

Respondents Public Utilities Commission of the State of California ("CPUC") and California Electricity Oversight Board ("CEOB") were petitioners in *Public Utilities Commission of California v. FERC*, 474 F.3d 587 (9th Cir. 2006) ("*PUC*"), and complainants in the underlying proceeding before the Federal Energy Regulatory Commission ("FERC" or the "Commission"). Respondents also intervened in *Public Utility District No. 1 of Snohomish County Washington v. FERC*, 471 F.3d 1053 (9th Cir. 2006) ("*PUD*"). This brief responds to the petitions seeking this Court's review of the decisions in *PUC* and *PUD*. References herein to the Ninth Circuit's opinion are to *PUD* unless otherwise indicated.[1]

---

[1] Unless otherwise noted, all references to "Dynegy Pet." and "Pet. App." are to the petition and appendix filed in No. 06-1468. All references to "Sempra Pet." are to the petition filed in No. 06-1454; all references to "MSCG Pet." are to the petition filed in No. 06-1457 and all references to "Calpine Pet." are to the petition filed in No. 06-1462.

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STATEMENT OF THE CASE

1. The Federal Power Act.

Congress enacted the Federal Power Act ("FPA"), 16 U.S.C. §§ 791a-828r, in order to protect the public interest by ensuring that consumers do not bear excessive rates. *See Pennsylvania Water & Power Co. v. FPC,* 343 U.S. 414, 418 (1952) ("A major purpose of the whole Act is to protect power consumers against excessive prices."). To this end, the FPA commands:

> All rates and charges . . . for or in connection with . . . the . . . sale of electric energy subject to the jurisdiction of the Commission . . . shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

16 U.S.C. § 824d(a) (FPA § 205(a)).

The FPA "makes unlawful all rates which are not just and reasonable, and does not say that a little unlawfulness is permitted." *FPC v. Texaco, Inc.*, 417 U.S. 380, 399 (1974) ("*Texaco*").

2. *Mobile* and *Sierra*.

In 1956, this Court both confirmed Congress's intention to secure the public's interest in just and reasonable rates, and distinguished that public interest from the private interests of companies contracting to buy and sell wholesale power between themselves. *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) ("*Mobile*"); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348

(1956) ("*Sierra*").[2] "[T]he purpose of the power given the Commission . . . is the protection of the public interest, as distinguished from the private interests of the utilities. . . . " *Sierra*, 350 U.S. at 355. In each case, the Court considered the following scenario: A private seller and a private buyer entered into a contract for the purchase and sale of gas or power for a period of time at specified rates; the contract was filed with the Federal Power Commission ("FPC"), FERC's predecessor, under FPA § 205, 16 U.S.C. § 824d, which provides a formal opportunity "upon complaint or upon [FERC's] own initiative" to challenge the contract before it takes effect; the FPC accepted the contract for filing; and the seller later sought unilaterally to raise the filed contract rates. The Court found nothing in the FPA (or the NGA) to authorize the FPC to allow unilateral increases in the rates above those specified in the previously filed contracts merely to protect the "private interests" of sellers who decided that the agreed-upon rates had become too low. *Sierra*, 350 U.S. at 355 (a private contract between two companies "may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility").

The FPC nevertheless retained full authority to review all wholesale power contracts and to modify them where the contract would "adversely affect the public interest," such as "cast[ing] upon other consumers an excessive burden." *Id.*

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[2] *Mobile* construes the Natural Gas Act, 15 U.S.C. §§ 717-717z ("NGA"); *Sierra*, the sister provisions of the FPA. This Court "cite[s] interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981) ("*Arkla*").

3. The Change to "Market-Based" Regulation.

Until the 1980s, FERC determined the justness and reasonableness of rates primarily on a cost-of-service basis: rates were matched "to the cost to the utility of providing the service, including 'the cost of prudently invested capital used to provide the service.'" Pet. App. at 254a (quoting *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 485 (2002) ("*Verizon*")). In a cost-based regime, FERC and any affected parties (including consumers and state commissions) had a meaningful opportunity to challenge the contract rates because the contracts themselves had to be filed at least 60 days prior to commencement of service, *see* 16 U.S.C. § 824d(c); 18 C.F.R. §§ 35.2(d), 35.3, 35.8, and FERC could suspend their effectiveness for five months pending review. *See* 16 U.S.C. § 824d(e).

By the late 1980s, FERC moved to an entirely new, so-called "market-based" regulatory regime. The theoretical underpinning of this market-based regime is that a competitive market will by its nature produce just and reasonable rates. *See, e.g.*, *Ocean State Power*, 44 FERC ¶ 61,261 (1988). Under this scheme, FERC authorized a particular seller to engage in market-based sales after FERC determined that the seller lacked market power – a conclusion based on an analysis of the seller's generation or transmission ownership and the availability of open-access transmission services in the relevant market. Pet. App. at 258a (citing FERC Order No. 888, 61 Fed. Reg. 21,540 at 21,553 (May 10, 1996)).

FERC's new regime, based on an *ex ante* assumption that the rates would be reasonable, provided no opportunity for the public to seek review of individual market-based rate agreements before they became effective. *See, e.g., El Paso Elec. Co.,* 108 FERC ¶ 61,071 at 61,372 (2004). Instead, once authorized, market-based sellers could enter into, and provide service under, power contracts without prior review by FERC. *See, e.g., Southern Co. Servs., Inc.,* 75 FERC ¶ 61,130 (1996) ("*Southern*"), *aff'd on reh'g*, 87 FERC ¶ 61,214 (1999). Short-term transactions (less than one year) could be reported quarterly; long-term agreements (of a year or more) had to be filed within 30 days after service commenced. *Southern*, 75 FERC at 61,444-45. Individual long-term agreements filed *ex post facto* with the Commission were submitted for "informational" purposes only, and were not treated as traditional FPA § 205 filings. Third parties could not intervene and challenge the justness and reasonableness of the rates. *See GWF Energy LLC,* 97 FERC ¶ 61,297 at 62,391 (2001) ("[T]he filing of such agreements does not serve as a vehicle to challenge the justness and reasonableness of either the agreements themselves or the underlying market-based rate authority.").

4. The Collapse of the Western Electricity Markets.

Starting in the late spring of 2000 and continuing for over a year, the markets for wholesale electricity in California (and elsewhere in the West) essentially stopped performing as competitive, or even functioning, markets. Wholesale rates for electricity in California and the West skyrocketed from historic norms of $34 per megawatt hour ("MWh") to in excess of $3,000/MWh; the California investor-owned utilities lost their creditworthiness (with the largest going bankrupt), and the California Independent System Operator ("ISO"), which was responsible for the stability of the regional grid, was forced to declare dozens of system emergencies, resulting in rolling blackouts across California. *See generally In re Cal. Power Exch. Corp.*, 245 F.3d 1110, 1114-15 (9th Cir. 2001); *see also California, ex rel., Lockyer v. FERC,* 383 F.3d 1006, 1009 (9th Cir. 2004), *cert. denied,* 551 U.S. ___ (June 18, 2007) ("*Lockyer*"); (Excerpts of Record ("ER-__") at 73, 116, 141, 158, 259, 263-69).

Following a Commission-directed Staff investigation, on November 1, 2000, the Commission concluded that the California markets were "seriously flawed": "there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the FPA." *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,121 at 61,349-50 (2000).

Because it deemed over-reliance on the spot market to be a significant flaw, FERC in a subsequent order "strongly urge[d]" California market participants to enter into long-term energy contracts (also called forward contracts). *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.* 93 FERC ¶ 61,294 at 61,984, 61,993 (2000) ("December 15, 2000 Order"). A forward contract is a contract to buy and sell power that will be generated and delivered on a future date. (ER-145-46.) Forward prices reflect whatever factors may be thought likely to affect future spot market prices, without regard to the legitimacy of those factors. (ER-149-50, 295.) If the market is not functioning and the exercise of market power raises spot prices, forward prices also will rise unless sellers and buyers believe that the conditions allowing the exercise of market power will quickly disappear. (ER-257.)[3] Recognizing that urging market participants to enter forward contracts had the potential to create a sellers' forward market, the Commission committed to "be vigilant in monitoring the possible exercise of market power" and "monitor prices in those [forward] markets" in order "[t]o address concerns about potentially unjust and unreasonable rates." December 15, 2000 Order, 93 FERC at 61,994.

5. The Subject Contracts.

On January 17, 2001, after the investor-owned utilities had become uncreditworthy, the Governor declared a State of Emergency and ordered that the California Department of Water Resources ("CDWR") "shall enter into contracts . . . for the purchase of electricity . . . as expeditiously as possible." (ER-77.) In the period between February 6 and August 23, 2001, CDWR executed 57 long-term power contracts, including those that remain at issue.[4] The prices in each of the contracts, which run as high as $249/MWh, reflected the expectation that the noncompetitive spot prices resulting from the market dysfunctions were likely to continue for the summer of 2001 and beyond. (ER-107, 413-26.)

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[3] Before the crisis abated, FERC expressly recognized this "critical interdependence among the prices in the ISO's organized spot markets, the prices in the bilateral spot markets in California and the rest of the West, and the prices in forward markets." *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 95 FERC ¶ 61,418 at 62,547 (2001).

[4] The contracts in dispute in the *PUC* proceeding are between CDWR and Dynegy Power Marketing, Inc. ("Dynegy"), Coral Power, LLC ("Coral"), Sempra Energy Resources ("Sempra") and PacifiCorp Power Marketing ("PPM").

Under California law, California's ratepayers must bear – directly – the rates of the CDWR contracts. Cal. Water Code § 80104 (2001) ("Upon the delivery of power to them, the retail end use customers shall be deemed to have purchased that power from [CDWR]. Payment for any sale shall be a direct obligation of the retail end use customer to [CDWR]."). Unless redressed, California consumers will be burdened with rates that exceed just and reasonable levels by at least $1.4 billion from just the four contracts remaining at issue. (ER-429-30.)

6. FERC's Rulings.

In February 2002, Respondents filed complaints under FPA § 206 asking FERC to determine whether the CDWR contracts, from the outset, were just and reasonable. Pet. App. at 18a-19a (¶ 1), 35a (¶ 35). Contrary to what Petitioners repeatedly state or imply, *see, e.g.,* Dynegy Pet. at 8, Respondents did not argue (and have never argued) that the CDWR contracts, even if just and reasonable when signed, could nevertheless later be modified merely because rates dropped. *See, e.g.,* Pet. App. at 279a.

Notwithstanding the known market dysfunction in California and its previously stated commitment to address concerns about unreasonable prices in the forward contracts entered during the crisis, FERC denied California ratepayers any relief, ruling:

a. The "grant of market-based rate authority constitutes what is known as the 'initial review' of rates." *Id.* at 34a (¶ 35).

b. By granting market-based authority to a seller, "the Commission pre-determines under Section 205 of the FPA that sales at market-based rates will be just and reasonable." *Id.* (¶ 34).

c. Respondents are not entitled to "another opportunity to argue that the rate was not just and reasonable at the outset." *Id.* at 35a (¶ 35).

d. Under the "*Mobile-Sierra* standard of review," a party must "show that a unilaterally proposed change is required by the public interest." *Id.* at 37a (¶ 40); *see also id.* at 25a (¶ 16), 44a (¶ 52).

e. A party cannot avoid this burden by "claiming that the rates were not just and reasonable when it signed the contract, unless there is evidence such as the seller fraudulently inducing the buyer to execute the contract." *Id.* at 33a (¶ 33).

f. "[A] finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a 'just and reasonable' standard of review. As we have concluded, the contracts at issue in this proceeding do not provide for such a standard but rather evidence an intent that the contracts may be changed only pursuant to the 'public interest' standard of review." *Id.* at 91a (¶ 37).[5]

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[5] In its "Final Report on Price Manipulation in Western Markets," FERC Staff found that the spot market dysfunctions along with tight supply fostered conditions such that numerous market participants, including Petitioners Dynegy, Sempra and Coral, were able, and did in fact, repeatedly game both the gas and electricity markets to artificially inflate prices. (ER-531-71); Supplemental Submission of Evidence and

(Continued on following page)

7. The Ninth Circuit's Decisions.

The Ninth Circuit found this approach to market oversight at odds with FERC's mandate under the FPA to ensure that the public is not burdened with unjust and unreasonable rates. Presented with contracts whose rates were never subject to review by FERC for justness and reasonableness under its market-based rate regime, whose fairness was instead predicated on an admittedly faulty assumption that they were the product of a functioning and competitive market, and whose costs would be borne directly by the public, the Ninth Circuit vacated FERC's

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Request for Relief of the California Electricity Oversight Board and the California Public Utilities Commission (March 3, 2003) at 19-22. These anticompetitive practices, including economic withholding, inflated bidding, wash trades, false data reporting to published price indices and the infamous Enron trading strategies with names like Death Star, Fat Boy and Get Shorty, led in part to the extraordinarily high spot market prices for natural gas and electricity during 2000 and 2001. *Id.* This in turn significantly affected forward prices. The Staff estimated the distortion of forward prices at upwards of $50/MWh (or 33%) for contracts, like Dynegy, of one to four years duration that began delivery in 2001. (ER-582-83, 589, Table V-6.)

FERC, however, ruled that the Staff's findings were not relevant under its formulation of the public interest standard. Pet. App. at 59a, 90a. FERC also affirmed the administrative law judge's prohibition of any discovery as to the Petitioners' participation in the widespread market manipulation in the California spot markets and the impact that manipulation had on forward prices and the judge's exclusion from evidence of the same on relevance grounds. Pet. App. at 85a.

These rulings undermine FERC's finding that Respondents failed to demonstrate any market manipulation "specific" to the contracts at issue. FERC's conclusion in this regard also ignores how markets work. Since the California electricity markets were dysfunctional such that "even small suppliers" were able to inflate prices above competitive levels, all sellers benefited irrespective of their behavior at the bargaining table. *See San Diego Gas & Elec.*, 93 FERC at 61,367.

decision, and remanded for further consideration. In so doing, the court opined in pertinent part as follows:

a. The court agreed with FERC that it may "adopt a regulatory regime that differs from the historical cost-based regime of the energy market," and that "market-based rate authority may be a tenable choice if sufficient safeguards are taken to provide sufficient oversight." Pet. App. at 295a.

b. The court agreed with FERC that, whatever regulatory scheme it adopts, it must provide "an opportunity for initial review of whether a rate is just and reasonable." *Id.* at 278a.

c. The court disagreed with FERC that the then-extant regulatory regime necessarily provided an opportunity for initial review. *Id.* at 291a-95a.

d. The court ruled that if the contract rates at the outset were so high as to be outside the zone of reasonableness, then they adversely affect the public interest and are subject to modification under the FPA. *Id.* at 302a-03a; *PUC*, Pet. App. at 12a.

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REASONS TO DENY THE PETITIONS

I. THE NINTH CIRCUIT'S DETERMINATION THAT THERE MUST BE AT LEAST ONE OPPORTUNITY TO REVIEW A CONTRACT'S JUSTNESS AND REASONABLENESS DOES NOT CONFLICT WITH PRECEDENT FROM THIS COURT OR ANY CIRCUIT.

Petitioners argue that the Ninth Circuit created a conflict meriting review when it agreed with FERC that the FPA requires at least one opportunity for the review of the justness and reasonableness of rates.[6] Dynegy Pet. at 13-14; Sempra Pet. at 14-17. There is no such conflict.

In both *Mobile* and *Sierra*, the issue was whether the Commission could allow the seller in an energy contract unilaterally to raise the rates that had been previously agreed upon and accepted by the Commission. In each case, the pre-existing rates were filed with the FPC under FPA § 205 (or its NGA equivalent) prior to their taking effect. *Mobile*, 350 U.S. at 336; *Sierra*, 350 U.S. at 352. The FPC retained the authority, "either upon complaint" or "upon its own initiative," to "enter upon a hearing concerning the lawfulness of such rate," and to further suspend effectiveness of the rate pending such hearing.

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[6] Petitioners' argument on this point is at odds with the position they took in their requests for rehearing at FERC, where they asked FERC to make an affirmative finding that the contracts were just and reasonable, recognizing that "[a]ll rates, terms and conditions of service must be 'just and reasonable' in order to be lawful under the FPA. . . . The *Mobile-Sierra* doctrine will not – indeed by definition cannot – countenance unjust and unreasonable rates." (ER-711, 712, 714.) Reiterating its view that it was bound to the "high burden" of the *Mobile-Sierra* standard, FERC declined to make the requested finding, as a "matter[ ] not before us in this case." Pet. App. at 36a (¶ 38).

Mobile, 350 U.S. at 334 n.1. In ruling that the seller could not later return to the Commission and unilaterally raise the previously filed rate without establishing that such an increase was somehow necessary to protect the public, the Court did not hold that the rates in the initial filing could have been insulated altogether from review. In reviewing *Mobile* and *Sierra* more recently, this Court acknowledged precisely the contrary, noting that the FPA granted to the Commission "an opportunity in every case to judge the reasonableness of the rate." *Arkla*, 453 U.S. at 582.[7]

Petitioners fare no better by pointing to decisions by other circuits in which the original contracts were never filed, and thus never subject to review. Dynegy Pet. at 16-17; Sempra Pet. at 16-17. In those cases, the party seeking abrogation of the contracts chose, in violation of the then-extant regulatory regime, not to file the contracts in the first instance. The courts in those cases simply held that such a party could not benefit from its failure to file the rate. *See, e.g., Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998, 1009 (D.C. Cir. 1975) ("*Sam Rayburn*") ("In any event, if the parties did by their conduct subsequently modify the 1950 contract, Gulf States and the FPC are bound by the modified terms, whether or not Gulf States met its responsibility of reducing the modifications to writing and filing them with the FPC."); *see also Borough of Lansdale v. FPC*, 494 F.2d 1104, 1117 (D.C. Cir. 1974) ("*Lansdale*").

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[7] Petitioners point to *Verizon*, 535 U.S. 467, for the proposition that Congress intended that when two "sophisticated businesses" enter an energy contract the rates are presumptively just and reasonable under the FPA. *See, e.g.,* Sempra Pet. at 4, 14 and 17; Calpine Pet. at 20. The cited language, even apart from being *dicta*, cannot be read to support the different proposition that a sophisticated buyer can be presumed to get a fair deal in a completely broken market, such as that present in California in 2001.

Petitioners also assert that this Court has never required that FERC must actually review every contractually agreed-upon rate, and they cite decisions of the courts of appeals applying the *Mobile-Sierra* reasoning to rates that were in fact never reviewed. Dynegy Pet. at 16-17; Sempra Pet. at 16-17. In so arguing, Petitioners miss the point: the Ninth Circuit held only that there need be an *opportunity* for review (as there always was under the cost-based regulatory regime), not that such a review must have in fact been conducted. *See* Pet. App. at 277a-80a ("In short, FERC is correct . . . that the *Mobile-Sierra* doctrine [applies] only if a newly-entered contract remains in effect *after* there is an opportunity for plenary, 'just and reasonable' agency review." (emphasis in original)). In each of the cases cited by Petitioners, the regulatory regime in fact required an initial filing of contracts with the Commission and thus provided such an opportunity for review. *See Northeast Utils. Serv. Co. v. FERC*, 993 F.2d 937, 960 (1st Cir. 1993) (previously filed Seabrook Power Contract); *Sam Rayburn*, 515 F.2d at 1006; *Lansdale*, 494 F.2d at 1113; *Natural Gas Pipeline Co. v. Harrington*, 246 F.2d 915, 919 (5th Cir. 1957); *see also Compania de Gas de Nuevo Laredo, S.A. v. FERC*, 606 F.2d 1024, 1026, 1029 (D.C. Cir. 1979) (involving different and somewhat inapposite gas export laws).[8] The Ninth Circuit's insistence that

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[8] Dynegy makes much of the fact that, unlike the other Petitioners, it actually filed its contract with FERC. Dynegy Pet. at 14. Dynegy, however, ignores that, as discussed above, FERC's rules governing its market-based rate scheme provided no opportunity for the public to seek individualized review of market-based rate agreements before they

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FERC have at least one opportunity to review the reasonableness of rates is rooted in the FPA itself, which requires that "all rates" for "any" sale of wholesale power be filed with FERC, together with all contracts that relate to such rates. *See* 16 U.S.C. § 824d; *Mobile,* 350 U.S. at 339 (affirming that, under the FPA, "the protection of the public interest [is] afforded by supervision of the individual contracts, which to that end must be filed with the Commission and made public").

In sum, neither this Court nor any court of appeals has ever held that the FPA does not require that there be at least one opportunity for meaningful review of rates that are within FERC's jurisdiction. In agreeing with FERC on this particular point, the Ninth Circuit created no conflict.

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became effective. *See, e.g., El Paso Elec. Co.*, 108 FERC at 61,372. The filing of a market-based contract was treated by FERC as merely "informational," with third parties precluded from intervening and challenging the justness and reasonableness of the rates. *See GWF Energy,* LLC, 97 FERC at 62,391. In any case, the Ninth Circuit expressly recognized that its holding would stand even if it had not rejected Dynegy's argument. *See PUC*, Pet. App. at 11a n.8 ("Even if [Dynegy's] argument succeeded on this point, it would not be sufficient to overcome the other portions of our opinion which provide independent reasons for granting PUC's petition for review."). Accordingly, certiorari on this issue would be inappropriate. *See Lewis v. Continental Bank Corp.*, 494 U.S. 472, 477 (1990) (courts should not "decide questions that cannot affect the rights of litigants in the case before them"); *Rice v. Sioux City Mem'l Park Cemetery, Inc.*, 349 U.S. 70, 74 (1955) ("[T]his Court does not sit to satisfy a scholarly interest in such issues. Nor does it sit for the benefit of the particular litigants.").

II. THE NINTH CIRCUIT DID NOT CREATE A CONFLICT WITH THE D.C. CIRCUIT IN HOLDING THAT THE GRANT OF MARKET-BASED RATE AUTHORITY WITHOUT ONGOING EFFECTIVE MARKET OVERSIGHT DOES NOT SATISFY THE FPA'S REQUIREMENT OF AN OPPORTUNITY FOR A JUST AND REASONABLE REVIEW.

The Ninth Circuit departed company with FERC over the argument that FERC's grant of market-based rate authority constituted a satisfactory "pre-determination" that the rates in all future negotiated contracts were just and reasonable. Contrary to Petitioners' claims (Dynegy Pet. at 13; Sempra Pet. at 18-22), the Ninth Circuit's ruling in this regard does not create a circuit split or mean that FERC may not under any circumstances use a market-based regulatory regime to satisfy its statutory obligations. Rather, "market-based rate authority *can* qualify as sufficient prior review to justify limited *Mobile-Sierra* review," provided it is "accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change." Pet. App. at 285a. Such procedures must be available to ensure that contract rates are the product of a functioning, competitive market and, therefore, can be expected to be within the zone of reasonableness. *Id.* at 303a. "Only then can FERC meet its statutory duty to ensure that *all* rates are 'just and reasonable.'" *Id.* at 287a (emphasis in original).

The Ninth Circuit found that FERC's regulatory scheme in place in 2001 did not "provide sufficient oversight for contracts made under market-based rate authority to ensure that the resulting rates were within the statutory 'just and reasonable' range in the first instance, thereby permitting reliance on the *Mobile-Sierra* doctrine as to the continuing effectiveness of those contracts." *Id.* at 289a. However, the court's prerequisites for application of *Mobile-Sierra* provide FERC ample leeway to decide how to provide such oversight going forward.

Petitioners argue that the Ninth Circuit's decision on this point conflicts with the D.C. Circuit's decision in *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993). Sempra Pet. at 18-19; Calpine Pet. at 12. In *Elizabethtown*, FERC authorized a gas pipeline and its customers to enter into a settlement whereby the pipeline would sell gas at individually negotiated market-based rates. *Id.* at 869. The settlement was challenged on the grounds that market-based pricing violated FERC's obligation to ensure just and reasonable rates. FERC rejected the challenge because it found that the subject market was competitive and at the same time FERC expressly reserved "its § 5 authority (upon its own motion or upon that of a complainant) to assure that a market (*i.e.*, negotiated) rate is just and reasonable." *Id.* at 870-71.[9]

Here, by contrast, FERC certainly did not find the subject markets to be competitive, yet it refused to provide any opportunity to assure that the rates are just and reasonable. Here, too, the Ninth Circuit found that FERC's market monitoring was inadequate, *PUC*, Pet. App. at 10a-12a,[10] an issue not reached in *Elizabethtown*. *Cf.* 10

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[9] Sections 4 and 5 of the NGA are substantively equivalent to sections 205 and 206 of the FPA.

[10] In fact, contrary to Petitioners' claims (*e.g.*, Sempra Pet. at 6), it is essentially uncontroverted that FERC did not exercise effective market oversight during the energy crisis. And there is substantial evidence that market manipulation and tariff violations occurred on a

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F.3d at 871. The *Elizabethtown* decision does not even mention *Mobile* and *Sierra*, much less consider how those decisions would apply to any subsequent challenge based on a claim that the subject market was not competitive at the time of contract formation.

The lack of conflict is underscored by the Ninth Circuit's reliance on the same precedent relied upon by *Elizabethtown*. *Compare Elizabethtown*, 10 F.3d at 870, *with* Pet. App. at 288a-89a (both citing *Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984), and *Texaco*, 417 U.S. 380). In *Farmers Union*, the D.C. Circuit found that FERC's market-based scheme did "not comport with FERC's statutory responsibilities" because it relied solely on market forces to drive prices into the zone of reasonableness, "[b]ut nothing in the regulatory scheme itself acts as a monitor to see if this occurs or to check rates if it does not." *Farmers Union*, 734 F.2d at 1509; *see also Interstate Natural Gas Assoc. of Am. v. FERC*, 285 F.3d 18, 34 (D.C. Cir. 2002) ("*INGAA*") (recognizing that *Farmers Union* "set great store" on "monitoring and assurance of remedies in the event of insufficient competition").

Likewise, this Court's decision in *Texaco* "bolster[s]" the Ninth Circuit's determination that FERC may not rely on a market-based methodology without adequate oversight. Pet. App. at 287a. In *Texaco*, this Court struck down an FPC order attempting to utilize a "blanket certificate procedure for small producers of natural gas" that would

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"massive scale" unchecked by any contemporaneous regulatory oversight. *See Lockyer*, 383 F.3d at 1014-15; *see also Pub. Utils. Comm'n of Cal. v. FERC*, 462 F.3d 1027, 1049 (9th Cir. 2006).

"relieve[] them of almost all filing requirements" based on the rationale that small producers' rates would be determined by market forces. *Texaco*, 417 U.S. at 382, 390. Agreeing with the D.C. Circuit, this Court concluded that the Commission's proposed "indirect regulation" of small producers through only market forces did not meet its statutory obligation because "the prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the Act." *Id.* at 395-97.

In sum, neither this Court nor the D.C. Circuit has ever held that FERC may satisfy its statutory obligation to ensure that all rates are just and reasonable by reliance on a market-based regulatory scheme devoid of any consideration of whether the market is functioning.[11]

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[11] Sempra also suggests that, even if the grant of market-based rate authority was not always an adequate substitute for an opportunity to review the justness and reasonableness of rates, in Sempra's case the grant was in fact adequate. *See* Sempra Pet. at 19. Sempra's reasoning is that because it received its market rate authority just three weeks before it signed its contract with CDWR, FERC implicitly found that the market was functioning and hence producing reasonable rates at the time of contract formation. Sempra's argument that this peculiar chronology unique to Sempra calls for a contrary result below does not warrant review by this Court and, in any event, is incorrect. Sempra in its application for market rate authority specifically disavowed any suggestion that the market was competitive, noting that its application was "not premised on the assumption that markets in California are working efficiently or competitively under current circumstances. What [Sempra] seeks . . . [is] simply to be put on the same footing as other suppliers in California or elsewhere. . . ." Application of Sempra for Market-Based Rates, Docket No. ER01-1178-000 (Feb. 6, 2001).

III. THE NINTH CIRCUIT'S DECISIONS DO NOT CONFLICT WITH *MOBILE* AND *SIERRA* OR CREATE A SPLIT IN THE CIRCUITS AS TO HOW THE PUBLIC INTEREST STANDARD APPLIES TO A MARKET-BASED CONTRACT GOVERNED BY THE FPA.

Petitioners also dispute the Ninth Circuit's formulation of the *Mobile-Sierra* public interest test in the context of this case – a "high-rate" challenge – where the CEOB and CPUC, acting on behalf of California consumers, asked the Commission to determine whether the contracts, from the outset, imposed unjust and unreasonable rates due to the absence of a functioning and competitive market at the time they were signed. The logic behind the Ninth Circuit's reasoning is straightforward: when the *Mobile-Sierra* standard of review applies, contracts that harm the public interest must be subject to reform; harm to the public interest includes burdening the public with market-based rates that are above the zone of reasonableness at contract formation; therefore, if the rates will be borne by the public *and* the rates at contract formation are outside the zone of reasonableness, the FPA requires that FERC provide relief for the public from that burden. Pet. App. at 300a-03a.

By focusing the inquiry on the "public interest," the court's decision is entirely consistent with *Mobile, Sierra* and their progeny. "That the purpose of the power given the Commission by § 206(a) is the protection of the public interest, as distinguished from the private interests of the utilities, is evidenced by the recital in § 201 of the Act that the scheme of regulation imposed 'is necessary in the public interest.'" *Sierra*, 350 U.S. at 355; *Mobile*, 350 U.S. at 344 ("contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest."); *Texaco Inc. v. FERC*, 148 F.3d 1091, 1097 (D.C. Cir. 1998) ("the public interest necessary to override a private contract . . . requires analysis of the manner in which the contract harms the public interest and of the extent to which abrogation or reformation mitigates the contract's deleterious effect"); *Boston Edison Co. v. FERC*, 233 F.3d 60, 65 (1st Cir. 2000) ("the Supreme Court said that the contract rate could be raised only if it offended the 'public interest' ").

Likewise, the Ninth Circuit's formulation of the public interest standard to address the "high-rate" circumstances of this case does not conflict with *Mobile* and *Sierra* or create a circuit split. In fashioning its test, the court correctly recognized that the particular and nonexclusive factors articulated in *Sierra* arose in the context where a utility seller sought a rate increase because the challenged rate was "too low." Pet. App. at 300a, citing *Sierra*, 350 U.S. at 355; *see also Mobile*, 350 U.S. at 345 ("And if the Commission, after hearing, determines the contract to be *so low* as to conflict with the public interest, it may under § 5(a) authorize the natural gas company to file a schedule increasing the rate.") (emphasis added).[12] In that context, the challenging utility faces a "high burden" because

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[12] Petitioners misconstrue this fundamental principle of *Mobile* and *Sierra*. *Compare* MSCG Pet. at 3 (asserting that *Mobile* and *Sierra* established, *inter alia*, that "FERC may disturb a valid wholesale contract only in the rare instance when the contract is causing extensive damage to the public interest") *and* Sempra Pet. at 1 (arguing that this Court announced in *Mobile* and *Sierra* that "the FPA requires valid contracts to be enforced except in extraordinary circumstances where the contracts are contrary to the public interest") *with Sierra*, 350 U.S. at 355.

"[r]ates asserted to be *lower* than those FERC would approve *ab initio* will not ordinarily directly affect the most obvious 'public interest' underlying the FPA – namely, avoidance of unnecessarily high rates for the consuming public." Pet. App. at 300a-01a (emphasis in original).

In recognizing this distinction between the public interest factors applicable in a high-rate versus the typical low-rate context, the Ninth Circuit's decision is entirely consistent with prior decisions of the First and D.C. Circuits, and supported by the Fourth Circuit's (and the Government's) recognition of *Sierra*'s meaning in its immediate aftermath. The First Circuit in *Northeast Utils. Serv. Co. v. FERC*, 55 F.3d 686 (1st Cir. 1995) ("*Northeast II*"), expressly recognized that the *Sierra* factors are intended to apply only in the low-rate context:

> The holding of Sierra is clear; what justifies protective action in the public interest by the Commission when it is considering whether a contract rate is too low is where the rate might impair the financial ability of the utility to continue to supply electricity, force electricity consumers to bear an excessive burden, or be unduly discriminatory. This definition of what is necessary in the public interest was formulated in the context of a low-rate case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases.

Northeast II, 55 F.3d at 690. The D.C. Circuit likewise has made clear that *Mobile-Sierra* focused on low rates: the "doctrine broadly holds that the Commission cannot order an *increase* in rates set in a fixed-rate contract, or reject the rates on grounds they are *too low*, unless and until a hearing has shown the rates to be lower than the public interest requires." *Lansdale*, 494 F.2d at 1114 n.43 (emphasis added).

This high-rate/low-rate distinction was the very first ramification of the *Mobile* and *Sierra* decisions recognized by the Commission and the appellate courts. In 1957, the Fourth Circuit in *South Carolina Generating Co. v. FPC*, 249 F.2d 755 (4th Cir. 1957) ("*S.C. Generating*"), reviewed an FPC order reducing the rate in a long-term contract on the grounds that it was unjustly and unreasonably high. The seller utility contracted to supply capacity to a neighboring utility for a 25-year term at a fixed price. One year after the contract was filed and accepted by the FPC, a proceeding was initiated to investigate whether the rates were just and reasonable. *Id.* at 759. After a hearing in which representatives for both utilities offered testimony supporting the contract but the Georgia public service commission opposed the contract as unfair, the FPC ordered the price reduced to a just and reasonable level. *Id.* Relying on *Mobile* and *Sierra*, decided just one year earlier, the seller challenged the FPC's authority to order this price change. *Id.*

The Fourth Circuit affirmed the FPC's order and distinguished *Mobile* and *Sierra* just as the Ninth Circuit has done here five decades later:

> [O]n examination [the sellers' argument] soon appears to be an attempt to generalize from a particular situation without recognizing the significant difference in the facts in the pending case. The Supreme Court was dealing with rates, too low to permit an adequate return according to accepted standards, which had been adopted to serve the interest of the producing utilities . . .

> but the public interest was served by the lower cost to the ultimate consumers. . . . In the pending case, to the contrary, we are dealing with a rate that was too high according to accepted standards of rate regulations. . . .
>
> We do not think that the Supreme Court denounced this accustomed procedure [i.e., just and reasonable review under section 205(e)] in the Mobile and Sierra cases when it concluded that the unusually low rates which the utilities had voluntarily set up to serve their own interests were not unjust or unreasonable; and hence the Commission in the pending case, bearing in mind that its duty is to protect the public interest as distinguished from the private interest of the utilities, and finding the contract rate is unreasonably high was justified in fixing a lower rate for the benefit of the retail consumers in Georgia after providing a reasonable return on the moneys invested by the utilities.

Id. at 761-62. This Court then denied certiorari, with the FPC's support. *South Carolina Generating Co. v. FPC,* 356 U.S. 912 (1958).[13]

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[13] The Solicitor General's rationale for opposing the grant of certiorari in 1958 remains quite apt:

> It is evident, as the Commission and the unanimous court below recognized, that this Court was not attempting to prevent regulation of contract rates, as petitioner contends, but was only protecting consumer interests and that the *Sierra* holding can have no application where, as here, the contract rates are found unjust and unreasonable – because excessive – and consequently an unwarranted burden on the ultimate consumer.

South Carolina Generating Co. v. FPC, Docket No. 57-697, Brief of the Federal Power Commission in Opposition (Feb. 13, 1958); *see also* Watt

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Nor does the Ninth Circuit's formulation of the public interest standard conflict with the D.C. Circuit's decision in *Potomac Electric Power Co. v. FERC,* 210 F.3d 403 (D.C. Cir. 2000) ("*PEPCO*"). In *PEPCO,* the buyer utility sought to reduce previously filed and approved rates charged under its transmission contract on the grounds that changed circumstances resulted in those rates significantly exceeding the current market. *Id.* at 406-07. The Commission rejected the buyer's characterization of the issue for hearing (which asked FERC to assess the justness and reasonableness of the contract rates), and "defined the issue instead to be whether the rates, *having been found to be just and reasonable when originally approved*, had become contrary to the public interest." *Id.* at 406 (emphasis added). Unlike Respondents in this case, the buyer presented no evidence that consumers would bear the burden of the rates, relying instead on "a bald claim that [its] ratepayers would derive benefit from a rate modification." *Id.* at 409. The buyer therefore lost, not because it was permissible to burden consumers with unjust and unreasonable rates or because the public interest standard was supposedly limited to the *Sierra* factors, but rather from a "failure of proof." *Id.* at 411. Moreover, even if *PEPCO* did suggest a high burden where a contract challenge is based on changed circumstances, such standard has no application where the challenge is based on the circumstances that existed at the time of contract formation.

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v. Alaska, 451 U.S. 259, 273 (1981) ("The Department's contemporaneous construction carries persuasive weight. . . . The Department's current interpretation, being in conflict with its initial position, is entitled to considerably less deference.").

Petitioners also characterize the Ninth Circuit's approach as "asymmetric," favoring buyers over sellers. Sempra Pet. at 26; Dynegy Pet. at 26. But the FPA's purpose is not to achieve symmetry; it is to protect the interests of the public. *Cf. Sunray Mid-Continent Oil Co. v. FERC*, 364 U.S. 137, 143 (1960) ("[T]he primary practical problem that led to the passage of the [NGA and FPA] was the great economic power of the [utilities] as compared with that of the communities seeking natural gas [and electric] service."). *Mobile* and *Sierra* make clear that FERC has no mandate to concern itself with protecting private interests unless doing so is necessary for the public interest. Such a differentiation in FERC's mandate not surprisingly leads to "asymmetric approaches," because determining whether an unreasonably high rate harms the public necessarily involves different considerations than determining whether an unreasonably low rate harms the public.[14] And the assertion that such asymmetry will wreak havoc on contracting is belied by the fact that the high-rate/low-rate dichotomy has been expressly recognized by the Commission and the courts for almost as long as *Mobile-Sierra* itself. *See S.C. Generating*, 249 F.2d at 762.

Contrary to Petitioners' claims, the Ninth Circuit's formulation also does not conflate the public interest test into simply a just and reasonable review. Under the court's formulation, a contract harms the public interest due to a high rate only when the rate is outside the zone of reasonableness at contract formation *and* the consuming public (as opposed to simply the private buyer itself) will be forced to bear that unjust charge through retail rates. Pet. App. at 302a. This focus on the impact on the consuming public wholly comports with precedent, especially this Court's admonition that even "a small dent in the consumer's pocket" may make a rate unjust and unreasonable and therefore "unlawful." *Texaco*, 417 U.S. at 399; *see also* Pet. App. at 302a. The court's articulation of the public interest standard set forth above, which "mirrors that endorsed by the D.C. Circuit for determination of a just and reasonable rate under a market-based rate regulation regime," confirms the dual elements that a buyer must prove to obtain relief. *See id.* at 303a (citing *INGAA*, 285 F.3d at 31-36).[15]

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[14] This "asymmetry" also manifests itself in FPA § 205(e), 16 U.S.C. § 824d(e), which exhibits a "statutory bias favoring retroactive rate reductions but not retroactive rate increases. . . ." *Belco Petroleum Corp. v. FERC*, 589 F.2d 680, 687 (D.C. Cir. 1978).

IV. REVIEW OF THE NINTH CIRCUIT'S DECISIONS AT THIS TIME WOULD BE INAPPROPRIATE FOR PRUDENTIAL REASONS.

Petitioners' arguments concerning the effect of the Ninth Circuit's decisions on new contracts, and new contract challenges, ignore both what the Ninth Circuit said and what FERC itself has done since 2001. The Ninth Circuit recognized that "a functioning marketplace will drive prices towards marginal cost, and therefore toward

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[15] The Ninth Circuit did not address, and this Court need not anticipate, the appropriate public interest test to be applied in a situation where a contract is entered into in a competitive market and later challenged by a buyer as too high. Nonetheless, the court's admonition that rates produced in a functionally competitive market are within the zone of reasonableness, *see* Pet. App. at 303a, refutes any notion that true "buyer's remorse" cases will receive any more favorable outcomes than in the past.

. . . a reasonable range, 'at least over the long pull'" and that "[e]ven if a particular rate exceeds marginal cost, . . . it may still be within this . . . 'zone of reasonableness' – if that higher-than-cost-based price results from *normal* market forces and is part of general trend towards rates that do reflect cost." Pet. App. at 303a (citing and quoting *INGAA*, 285 F.3d at 31-32) (emphasis added); *see also Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990). FERC, in turn, has modified its market-based regime by taking various actions that, in its view, provide "appropriate market safeguards . . . to prevent a repeat of the California 2000-2001 energy crisis." *CAlifornians for Renewable Energy, Inc. v. Cal. Pub. Utils. Comm'n*, 119 FERC ¶ 61,058 at ¶ 30-40 (2007) ("*CARE*").[16] FERC posits that its new regulatory regime provides the requisite assurance of market competitiveness through enhanced scrutiny at the issuance of market-based rate authority and improved market monitoring. *Id.* at ¶ 31. Future contracting and future challenges will occur in the context of these new rules and procedures, the adequacy of which is not at issue here.

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[16] According to FERC, its post-crisis market reforms include: remedies for market manipulation and other market abuses; enhanced civil penalty authority; and the Office of Enforcement, created to enhance FERC's market oversight. CARE, 119 FERC at ¶¶ 32, 33, 35 & 37. Most recently, FERC issued an extensive and detailed final rule amending its market-based rate authorization regulations. Order No. 697, *Market-Based Rates for Wholesale Sales of Elec. Energy Capacity and Ancillary Servs. by Pub. Utils.*, 119 FERC ¶ 61,295 (June 21, 2007). FERC characterized this rule as "providing a rigorous up-front analysis of whether market-based rates should be granted, including protective conditions and ongoing filing requirements in all market-based rate authorizations, and reinforcing its ongoing oversight of market-based rates." *Id.* at ¶ 2. Tacitly conceding this was not so during the energy crisis, FERC also noted that "[t]he specific components of this rule, in conjunction with other regulatory activities, are designed to ensure that market-based rates charged by public utilities are just and reasonable." *Id.*

Petitioners' argument that the Ninth Circuit's decisions will result in a flood of challenges by parties seeking to escape pre-existing contracts is belied by FERC's recent treatment of the complaints in *CARE*. The complaining party, relying upon the *PUD* and *PUC* decisions, demanded that FERC abrogate two market-based contracts entered into in 2007. *CARE*, 119 FERC at ¶ 3 (citation omitted). FERC rejected the complainants' arguments and dismissed the complaints. *Id.* at ¶¶ 41-45. As such, there is as yet not a single post-*PUD* market-based rate decision from FERC that has ordered relief.

Finally, Petitioners' dire prediction of harm to electricity markets completely ignores the necessity of fairness and integrity for the success of any market. It is axiomatic that, for a market to be both liquid and competitive, there must be confidence that the market is fair and free of manipulation. *Cf. Silver v. New York Stock Exch.*, 373 U.S. 341, 355 (1963) ("engendering in the public a loss of confidence" in a stock exchange could "significantly impair fulfillment of the Exchange's function in our economy," and regulations to reduce the risk of such harm are "just and adequate to insure fair dealing and to protect investors") (internal quotation marks and citation omitted); *Oversight Hearing on the Monetary Policy Report to Congress Pursuant to the Full Employment and Balanced Growth Act of 1978 Before the S. Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 44 (July 16, 2002) (Statement of Alan Greenspan, Chairman of the Bd. of Governors of the Fed. Reserve Sys.) ("Well-functioning markets require accurate information to allocate capital and other resources, and market participants must have confidence that our predominately voluntary system of exchange is transparent and fair.").[17] In this important respect, the Ninth Circuit decisions facilitate the functioning of the markets in this industry.

In sum, the Ninth Circuit well applied the basic principles of the FPA and prior precedent to what no one disputes was an unprecedented market crisis under a regulatory regime that clearly did not anticipate such a crisis. FERC's post-crisis reforms to that scheme have not yet been tested in practice or in the courts. Accordingly, it makes sense to allow FERC and the circuit courts to address these issues in the first instance before this Court determines whether it need consider how best to proceed. *See, e.g., Lackley v. Texas*, 514 U.S. 1045, 1045 (1995) (Stevens, J., respecting denial of certiorari) (noting that denial of certiorari gives the opportunity to further study the disputed issue); *Virginia Military Inst. v. United States*, 508 U.S. 946, 946 (1993) (Scalia, J., respecting the denial of certiorari) (the Court "generally await[s] final judgment in the lower courts before exercising [its] certiorari jurisdiction.").

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[17] *See, e.g.*, Exh. CAL-3 at 15:14-20 ("Until [state policy makers] receive assurances that electric industry restructuring will not lead to catastrophic failure, they are unlikely to restart their restructuring efforts. FERC can provide the necessary assurance by adjusting the DWR contracts and demonstrating that, if something does go drastically wrong, there will be a remedy."); Exh. CAL-90 at 73:22-74:4 ("It appears that the public has lost confidence in the benefits of electric industry restructuring. Competitive markets have the potential to achieve a degree of efficiency not possible for regulated markets to achieve. Without assurance of adequate regulatory oversight of competitive markets, however, it appears the public will not support restructuring and without restructuring, potential competitive efficiencies will not be realized.").

CONCLUSION

For these reasons, the petitions should be denied.

Respectfully submitted,

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IN THE
Supreme Court of the United States

DYNEGY POWER MARKETING, INC., *ET AL.*,
Petitioners,
v.
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

REPLY FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

The Ninth Circuit's decision can be reconciled with neither *Mobile* and *Sierra*, nor the decisions of other circuits applying those cases. The decision, moreover, casts doubt on billions of dollars' worth of contracts and creates a pall of uncertainty over when future contracts will be subject to regulatory or judicial second-guessing—precisely what the *Mobile-Sierra* doctrine was designed to avoid.

Respondents either do not address, or seek to minimize, these issues. Not one defends the Ninth Circuit's primary basis for refusing to apply *Mobile-Sierra* to the Dynegy contract—that *Mobile-Sierra* is inapplicable where FERC "accepts" rather than "approves" rates for filing (Pet. App. 11a-12a). Their refusal to defend the Ninth Circuit's reasoning is unsurprising; the very same language the Ninth Circuit relied on here also appeared in the agency orders at issue in *Mobile* and *Sierra* themselves. The Ninth Circuit's flawed and undefended ruling on this point also squarely conflicts with decisions of the First and D.C. Circuits (Pet. 14-17). That is reason enough to grant the petition.

Respondents' attempt to invoke alternative grounds fares no better. Those grounds are not independent, do not diminish the importance of the Ninth Circuit's decision on this issue, and are themselves equally worthy of review. The Ninth Circuit did not merely "elaborate" on *Mobile-Sierra*; the Ninth Circuit eviscerated it. The court stated that *Mobile-Sierra* does not apply when new information about the extent of "market dysfunction" emerges—and that *Mobile-Sierra* thus did not apply here because, at "the time Dynegy filed its contract, the full scale" of "market dysfunction was not nearly as fully known as it is today." Pet. App. 11a-13a. It further held that FERC must set aside contracts whenever agreed-upon prices are above a "zone of reasonableness." *Id.* at 14a-15a. *Mobile-Sierra* cannot accomplish its purpose of providing contractual certainty if parties must speculate whether their bargains will be repudiated based on such notions. Those faulty standards, which create a conflict with other circuits (Pet. 19-20, 23-26), warrant review.

While FERC asserts that it has "sufficient discretion" on remand under the Ninth Circuit's decision (U.S. Br. in Opp. 12; see Snohomish Br. in Opp. 1), *Mobile-Sierra* is designed to *restrict FERC's* authority. That FERC may not be challenging the doctrine's evisceration is thus no reason to deny review. And while FERC urges a wait-and-see approach—speculating that the Ninth Circuit's decision may be confined to the "unique" circumstances of the particular energy crisis at issue here—industry participants cannot be so sanguine. They should not be forced to endure the very sort of contract uncertainty that *Mobile-Sierra* was designed to prevent.

ARGUMENT

I. RESPONDENTS OFFER NO VIABLE DEFENSE OF THE NINTH CIRCUIT'S HOLDING THAT *MOBILE-SIERRA* IS INAPPLICABLE TO CONTRACTS THE COMMISSION "ACCEPTS" BUT DOES NOT "APPROVE"

The Ninth Circuit's first and primary basis for not applying *Mobile-Sierra* in Dynegy's case was that, although Dynegy filed its contract with FERC, FERC's order merely "accepted" the contract for filing and "did not give prior *approval* to the Dynegy contract." Pet. App. 12a (emphasis added). As Dynegy has explained (Pet. 12-17), that holding conflicts with decisions of the First and D.C. Circuits, which accord *Mobile-Sierra* protection to contracts that have been accepted but not approved. And it is irreconcilable with *Mobile* and *Sierra* themselves, *both* of which involved orders with identical language accepting the contracts for filing but not approving them. Pet. 17-18 & n.8.

Respondents never address, much less rebut, that showing of a clear circuit split. Nor do they attempt to defend the Ninth Circuit's decision on the merits. Instead, California invents an alternative rationale the Ninth Circuit did not accept—that Dynegy's filing was merely "informational" and thus did not offer an "opportunity for the public to seek individualized review," Cal. Br. 13-14 n.8. But the only authority California cites, *GWF Energy, LLC*, 97 FERC ¶ 61,297 (2001), supports Dynegy's position. In *GWF*, FERC's order *expressly stated* that FERC was accepting the contract only "for informational purposes." *Id.* at 62,392; see also *Long Beach Generation LLC*, 120 FERC ¶ 61,297 (2007). Here, by contrast, FERC's order accepting the Dynegy contract did *not* include any such language. *GWF* proves that FERC knows how to say it is accepting a filing "for informational purposes" when that is what it means to do. It thus comes as no surprise that the United States (representing FERC) both declines to defend the Ninth Circuit's distinction between "accepting" and "approving" a filing, and declines to endorse California's new theory that Dynegy's filing was merely "informational." See U.S. Br. 14 n.2. That even the expert agency charged with administering the statute does not endorse California's argument speaks volumes about its merits.

California's claim that there was no "opportunity for the public to seek individualized review" is impossible to reconcile with the fact that, after Dynegy's contract was submitted, the CPUC and CEOB intervened in proceedings before FERC and litigated the case to finality in 2001. *Dynegy Power Mktg., Inc.*, 95 FERC ¶ 61,371 (2001). They *chose* to raise "no substantive issues," *id.* at 62,401, even though they were strenuously arguing in other cases that the California electric market was dysfunctional, Pet. 5-6. Having already litigated the contracts before FERC once, California cannot plausibly claim it had no opportunity to address these issues before.

In any event, no respondent denies that the Ninth Circuit created a square circuit conflict on this issue. The D.C. and First Circuits have both held that *Mobile-Sierra* applies to contracts that are accepted for filing. Pet. 15. In the Ninth Circuit, by contrast, it is now the law that mere "acceptance" of a contract for filing is insufficient. Pet. App. 11a-12a. That issue is no less pressing merely because the Ninth Circuit purported to offer *other* erroneous grounds for vacating FERC's order (U.S. Br. 14 n.2; Cal. Br. 13-14 n.8). That holding now applies in *every* case where FERC merely "accepts" a contract for filing, whether or not FERC also commits the other supposed "errors" the Ninth Circuit identified. In any event, as shown below, the other "errors" identified by the Ninth Circuit are independently worthy of review. Indeed, they all derive from the same false premise—that *Mobile-Sierra* implements a doctrine based on prior regulatory approval rather than one that respects voluntary agreements between sophisticated parties. The Court thus should settle the circuit split on this important and broadly recurring issue.[1]

II. *MOBILE-SIERRA* IS NOT INAPPLICABLE MERELY BECAUSE PARTIES LATER HAVE BETTER INFORMATION THAN WHEN THEY AGREED TO A CONTRACT

This Court should also grant the petition to review the Ninth Circuit's erroneous holding that, even where a contract is properly filed with FERC, *Mobile-Sierra* is inapplicable if "the full scale of spot market manipulation and forward market dysfunction was not nearly as fully known" at the time of contracting as it is today. Pet. App. 12a. That ruling is particularly pernicious here because, at the very time California executed the contract with Dynegy, it was claiming market dysfunction in other proceedings. Pet. 5-6. The Ninth Circuit's holding thus allows parties to avoid *Mobile-Sierra*—and escape bargained-for agreements—

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[1] Although FERC's new market-rate program relieves many entities of the obligation to file contracts in favor of periodic reporting, the issue remains vitally important for those regions and participants that no longer qualify for market-rate authority and must file long-term contracts with FERC. See *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity, & Ancillary Servs. by Pub. Utils.*, Order No. 697, FERC Stats. & Regs. ¶ 31,252 paras. 91, 659 (2007), reh'g pending (codified at 18 C.F.R. Part 35).

merely because more information later emerges about the *extent* of an already known risk.

The Ninth Circuit's holding conflicts with the First Circuit's decision in *Northeast Utilities Service Co.* v. *FERC*, 993 F.2d 937 (1st Cir. 1993) ("*NUSCO I*"). *NUSCO I* holds that, while market power (one form of market dysfunction) may be relevant to the public-interest analysis conducted *under Mobile-Sierra*, it is not a basis for refusing to apply *Mobile-Sierra* in the first place. Pet. 19-20. That was precisely the approach FERC took here—it looked at the extent of market dysfunction when applying the public-interest analysis under *Mobile-Sierra*, rather than treating it as a precondition to applying *Mobile-Sierra*. U.S. Br. 16-17. And that was precisely the approach the Ninth Circuit rejected. Pet. App. 12a-13a.

The United States claims that *NUSCO I* is "consistent" with the decision below because, on remand there, FERC considered market power as a factor *under Mobile-Sierra* and the First Circuit affirmed that later order in *Northeast Utilities Service Co.* v. *FERC*, 55 F.3d 686 (1st Cir. 1995) ("*NUSCO II*"). But there is a fundamental difference between considering market power or dysfunction *as part of* the *Mobile-Sierra* analysis, and citing such factors as a reason *not to apply Mobile-Sierra* at all. When market dysfunction is considered *under Mobile-Sierra*, it is one of many factors; FERC will still uphold a contract despite market dysfunction if, on balance, the demanding public interest test has not been satisfied. Under the Ninth Circuit's approach, by contrast, market dysfunction (more specifically, new information about the *extent* of dysfunction) is, *standing alone*, grounds for rejecting *Mobile-Sierra* and applying a "just and reasonable" standard instead.

The United States' claim that these approaches may be indistinguishable is belied by the result in this very case. FERC *did* consider market dysfunction *under* the *Mobile-Sierra* standard (U.S. Br. 16-17), but the Ninth Circuit overturned its order. If the distinction is of no moment, why did the Ninth Circuit vacate and remand? Respondents offer no answer. The United States' theory of "no difference" is also belied by *NUSCO*. In *NUSCO I*, the First Circuit *remanded* FERC's order when FERC relied on market power as a reason to apply the "just and reasonable" standard rather than the "public interest" standard, 993 F.2d at 962; in *NUSCO II*, the First Circuit *affirmed* FERC's order after FERC made more extensive findings that justified overturning the contract *under* the "public interest" standard. Those approaches clearly are not interchangeable. Because the Ninth Circuit adopted one (making market dysfunction a reason to refuse to apply *Mobile-Sierra*) and the First Circuit chose the other (holding that dysfunction can only be considered when applying *Mobile-Sierra*), this Court's review is warranted.

The Ninth Circuit's decision, moreover, is incorrect. Where parties enter into a fixed price contract with imperfect information, the contract necessarily allocates the risk that one side or the other will regret its decision when additional information later comes to light. Pet. 22 & n.11. Here the CPUC and CEOB had alleged that there was market dysfunction and manipulation even as California was entering into the Dynegy contract. Pet. 5-6 & n.3. By entering into the contract, California purchased certainty in the face of that and other unknowns. If the dysfunction turned out to be *less* widespread than the parties estimated, Dynegy would not have been permitted to invoke that hindsight to escape its obligations to California. By the same token, California cannot rely on those known risks as a reason to repudiate *its* bargain. Unless *Mobile-Sierra*'s demanding public interest test is met, sophisticated parties in an arms' length contract must live with the allocation of risks—particularly identified risks—they establish in their contracts.

The Ninth Circuit's approach also ignores bedrock principles of finality. Where a contract is filed with FERC, the resulting proceedings offer interested parties their exclusive opportunity to challenge the justness and reasonableness of the contract. Pet. 21. Litigants cannot reopen final FERC decisions merely because they later discover new information that affects their valuation of a contract. Yet that is exactly what the Ninth Circuit allowed here.

III. THE NINTH CIRCUIT'S RECONFIGURATION OF THE PUBLIC INTEREST TEST CONFLICTS WITH DECISIONS OF OTHER CIRCUITS

Finally, this Court should review the Ninth Circuit's holding that FERC must set aside contracts under *Mobile-Sierra* merely because the price is above some ill-defined "zone of reasonableness." Pet. App. 13a-15a. As the Ninth Circuit candidly acknowledged, its holding establishes a double standard between high-rate and low-rate cases. Pet. App. 13a-15a. Notably, the United States does not deny the existence of a circuit split on this issue. And although California and Snohomish expend considerable effort attempting to obscure the conflict, their efforts fall short.

The decision below directly conflicts with *Potomac Electric Power Co.* v. *FERC*, 210 F.3d 403 (D.C. Cir. 2000), which applied the traditional *Mobile-Sierra* standard to a high-rate contract challenge by a buyer of transmission services. Pet. 23-24. Although respondents argue that *Potomac Electric* merely involved a failure of proof (Cal. Br. 24; Snohomish Br. 22), the D.C. Circuit made clear that the applicable standard was the traditional *Mobile-Sierra* public-interest standard applied in typical low-rate cases. *Potomac Electric*, 210 F.3d at 412 (citing *Sierra*, 350 U.S. at 355). The decision below, by contrast, insists that an entirely different public-interest standard applies.

Snohomish attempts to distinguish *Public Service Commission of New York* v. *FPC*, 543 F.2d 757 (D.C. Cir. 1974) ("*PSCNY*"), urging that the court in that case allowed FERC to impose a lower rate than the parties had sought. Snohomish Br. 22-23. But that lower rate was an initial price condition on the grant of a Section 7 certificate, which, as the court recognized, "does not ordinarily implicate the *Mobile-Sierra* rule." 543 F.2d at 794. Later contract modifications by FERC *were* invalidated under *Mobile-Sierra*, because "[e]xcept as the exigencies of the public interest demanded, the Commission was *no more at liberty to alter the lease-sale contract to the prejudice of the producers than to do so in their favor.*" *Id.* at 798 (emphasis added).

Equally unavailing is Snohomish's claim (Br. in Opp. 23) that *PSCNY* is inapplicable because it concerned only "a contract between natural gas producers and pipelines, with no clear implications for ultimate gas consumers." As the court in *PSCNY* was well aware, 543 F.2d at 771, the purchaser was a price-regulated entity that would have had to pass through the bulk of its savings to its customers. *PSCNY* too directly conflicts with the decision below.[2]

The Ninth Circuit also established an indefensible rule. California and the consumers it represents had ample opportunity to challenge the "reasonableness" of Dynegy's rates in the proceedings following the filing of Dynegy's contract with FERC. Those proceedings were litigated to finality. Parties to a contract should not be permitted to return to FERC years later and seek to rewrite a contract for no better reason than that the rates now seem above the "zone of reasonableness" in hindsight. To allow buyers, but not sellers, to bring such challenges is doubly unfair. *Mobile-Sierra* prescribes no such one-sided rule.

IV. THESE IMPORTANT AND RECURRING ISSUES WARRANT IMMEDIATE REVIEW

All three questions presented by the petition are recurring and important. Although respondents and the United States claim otherwise—asserting that the California energy crisis was a unique historical event—the Ninth

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[2] California cites (Br. in Opp. 22-23) a 50-year old Fourth Circuit case for the proposition that buyers are subject to a different standard than sellers. Far from diminishing the importance of the issue, however, that case deepens the conflict and thus underscores the need for review.

Circuit's decision offers no such assurances. Nothing in the Ninth Circuit's decision suggests that its distinction between rates that are merely "accepted" and those that are "approved," see Pet. 14-17; pp. 2-4, *supra*, is somehow limited to litigation arising out of the California energy crisis. For years, FERC has been "accepting" rates without "approving" them (as it did in *Mobile* and *Sierra* themselves). The Ninth Circuit's holding casts doubt on all those contracts.

Likewise, the Ninth Circuit's other holdings do not purport to be limited to cases arising from the California energy crisis. "Market dysfunction" is an amorphous concept that is easy to allege, particularly in the notoriously volatile energy markets. It can be difficult to distinguish between the effects of legitimate scarcity, market fundamentals, and manipulation. If the Ninth Circuit's decision is affirmed, disappointed buyers will have powerful incentives to challenge contracts whenever new information about market conditions emerges that could plausibly be described as "dysfunction," or whenever agreed-upon prices seem too high in retrospect. The fact that FERC may eventually reject some challenges will not spare sellers from the costs of defending their contracts in litigation. The result will be precisely the contractual uncertainty and instability that *Mobile-Sierra* was meant to avoid.

The electric industry requires massive new capital investment in the coming years—hundreds of billions of dollars—to meet anticipated consumer demand. EPSA Br. 8–14; CEA Br. 8–13; ISDA Br. 16–18. The gas industry also faces similar contractual uncertainty. INGAA Br. 3-4. Investors will be far less willing to finance new energy infrastructure projects if they can only speculate whether their contracts will be honored. *Ibid.* As a result, the ultimate losers will be consumers themselves: California's temporary "rolling blackouts" were nothing compared to the consequences of an energy industry that, because of payment uncertainty, cannot develop capacity to meet consumer demand.

Even if the Ninth Circuit's holding were later limited to "crisis" situations, the case would still be a matter of profound public interest—even apart from the uncertainty that would persist until that limitation actually occurred. California's energy crisis was severe, but it will not be the last time that the energy markets—electric and gas—are confronted with fluctuating prices and uncertainty. If suppliers know their contracts will be honored, they can help buyers reduce that uncertainty by offering long-term contracts at fixed prices. Those risk-reducing contracts are most valuable *precisely when* markets are in a state of rapid flux. But if the Ninth Circuit's decision stands, no rational supplier would enter into such a heads-I-win, tails-you-lose agreement (particularly because any additional risk premium would simply be cited as evidence of unreasonable pricing). Absent suppliers willing to deal, energy purchasers will be denied the ability to hedge their risks (at least absent exorbitant premiums to compensate for legal risks) precisely when the ability to hedge matters most. The losers will be consumers themselves.

Finally, regardless of the Ninth Circuit decision's *prospective* impact, these cases are important even on a standalone basis. As California acknowledges, the amount at stake in the *PUC* case alone is a *minimum* of $1.4 billion. Cal. Br. 7. While FERC may prefer to urge the Court to wait and see how the Ninth Circuit's ruling plays out in future cases (U.S. Br. 17-18), the contracts at issue represent real money that California agreed to pay petitioners but is now seeking to recoup, with the Ninth Circuit's blessing. That alone is reason enough to grant the petition and settle the important legal questions presented.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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In the
Supreme Court of the United States

SEMPRA GENERATION *et al.*, PETITIONERS,
v.
PUBLIC UTILITIES COMMISSION OF THE STATE OF CA, *et al.*

MORGAN STANLEY CAPITAL GROUP INC., PETITIONER,
v.
PUBLIC UTILITY DIST. NO. 1 OF SNOHOMISH COUNTY WA, *et al.*

CALPINE ENERGY SERVICES, L.P., *et al.*, PETITIONERS,
v.
PUBLIC UTILITY DIST. NO. 1 OF SNOHOMISH COUNTY WA, *et al.*

DYNEGY POWER MARKETING, INC., *et al.*, PETITIONERS,
v.
PUBLIC UTILITIES COMMISSION OF THE STATE OF CA, *et al.*,

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF THE ELECTRIC POWER SUPPLY ASSOCIATION, COLORADO INDEPENDENT ENERGY ASSOCIATION, INDEPENDENT ENERGY PRODUCERS ASSOCIATION, INDEPENDENT POWER PRODUCERS OF NEW YORK, NEW ENGLAND POWER GENERATORS ASSOCIATION, INC., NORTHWEST & INTERMOUNTAIN POWER PRODUCERS COALITION, AND WESTERN POWER TRADING FORUM AS *AMICI CURIAE* IN SUPPORT OF PETITIONS FOR CERTIORARI

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QUESTION PRESENTED

Under the Federal Power Act, as interpreted by this Court in *United Gas Pipe Line Co. v. Mobile Gas Serv. Co.*, 350 U.S. 332 (1956), and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), the Federal Energy Regulatory Commission is prohibited from abrogating the terms of valid wholesale power contracts except in extraordinary circumstances of unequivocal public necessity. In conflict with decisions of this Court and every other Court of Appeals to consider the issue, the Ninth Circuit held that the Commission may nullify a wholesale power contract, even in the absence of public necessity, if the contract rates were not pre-approved by the Commission or if the contract is later deemed to have been formed during a period of market "dysfunction."

The questions presented are:

1. Whether the Ninth Circuit erred in failing to abide by this Court's decisions precluding the Federal Energy Regulatory Commission from retroactively abrogating valid, bilaterally negotiated wholesale energy contracts absent a showing that abrogation is required in the public interest.

2. Whether the Ninth Circuit erred in effectively determining that the *Mobile-Sierra* public-interest standard applies to sellers, but not buyers, that are seeking to escape the terms of freely negotiated wholesale power contracts.

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INTEREST OF *AMICI CURIAE*[1]

Amici and their members represent a diverse array of participants in the Nation's electric and natural gas industries, and are directly affected by the issues raised in these cases. *Amici* and their members have made long-term financial commitments, involving hundreds of billions of dollars, in reliance on this Court's settled authorities protecting the integrity of privately negotiated wholesale power contracts. Because the Ninth Circuit decisions purport to grant the Federal Energy Regulatory Commission never-before-recognized authority to abrogate such contracts, *amici* are concerned that the decisions below will destabilize the Nation's power markets, discourage much-needed investment, and ultimately lead to higher costs for consumers.

***The Electric Power Supply Association* ("EPSA")**. EPSA is a national trade association representing competitive electric power suppliers, including independent power producers, merchant generators, and power marketers. EPSA's mission is to promote legislative and regulatory policies encouraging a competitive market for electricity.

***Colorado Independent Energy Association* ("CIEA")**. CIEA is a trade association of competitive independent power producers, who are an integral part of Colorado's energy industry, producing electricity with clean, efficient natural gas-fired cogeneration and renewable technologies.

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[1] Petitioners and respondents have consented to the filing of this brief in letters on file in the Clerk's office. Pursuant to S. Ct. R. 37.6, *amici* state that no counsel for a party authored any part of this brief. No person or entity other than *amici*, their members, or their counsel made a monetary contribution to the preparation or submission of this brief. The attorneys preparing this brief direct the Court's attention to the fact that a second brief as *amicus curiae* will be filed in these same cases on behalf of the Natural Gas Supply Association by different attorneys from the same law firm. Although the attorneys working on the two briefs have shared work product and engaged in joint efforts, the resulting briefs are independent statements reflecting the independent views of the respective clients on whose behalf each of the two individual briefs are being filed.

***Independent Energy Producers Association* ("IEP").** IEP is a California non-profit mutual benefit corporation whose members collectively own and operate approximately one-third of California's installed generating capacity. IEP seeks to reduce dependence on imported energy sources, and to encourage supply options that benefit society economically, socially, and environmentally.

***Independent Power Producers of New York* ("IPPNY").** IPPNY is a New York State not-for-profit trade association of independent power producers that is committed, among other things, to ensuring that contractual and regulatory agreements and commitments are fully honored.

***New England Power Generators Association, Inc.* ("NEPGA").** NEPGA is the largest trade association representing electric generating companies in New England. Its mission is to promote sound energy policies that further economic development, jobs, and balanced environmental policy.

***Northwest & Intermountain Power Producers Coalition* ("NIPPC").** NIPPC represents developers, owners, and operators of non-utility power plants in the Northwest and Intermountain region. The electricity generated at these plants is delivered under long-term contracts to utilities or sold in the spot market.

***Western Power Trading Forum* ("WPTF").** WPTF is a California non-profit, mutual benefit corporation whose members actively participate in California's restructured electricity markets and are dedicated to enhancing competition. WPTF's broad-based membership includes energy service providers, scheduling coordinators, generators, energy consultants, and public utilities.

INTRODUCTION

For more than fifty years, the Federal Power Act has protected the integrity of contracts. Buyers and sellers of wholesale power have negotiated long-term, fixed-rate contracts with the guarantee that the Federal Energy Regulatory Commission, the Federal Power Commission's successor, has no authority to abrogate those contracts except in extraordinary circumstances "when necessary in the public interest." *United States Gas Pipe Line Co. v. Mobile Gas Serv. Co.*, 350 U.S. 332, 344 (1956).

The decisions below upend the balance struck by Congress and long recognized by this Court and various Courts of Appeals. In an abrupt, unwarranted break from precedent, the Ninth Circuit reinterpreted the Federal Power Act, granting the Commission new authority to abrogate valid contracts if the Commission has not pre-approved the contract rates or if the contracts are later deemed to have been formed during a period of market "dysfunction." *Public Util. Dist. No. 1 of Snohomish County v. FERC*, 471 F.3d 1053, 1061, 1086 (9th Cir. 2006); *Public Utils. Comm'n of Cal. v. FERC*, 474 F.3d 587, 594-96 (9th Cir. 2006). Even more troubling, the Ninth Circuit fundamentally altered the even-handed public-interest standard applied in earlier cases, effectively holding that henceforth only buyers, but not sellers, are entitled to protection from Commission-imposed contract abrogation.

Amici file this brief to emphasize the practical importance of the questions presented. Most importantly, it is essential that the Court appreciate the grave, potentially disastrous effects the Ninth Circuit decisions are likely to have on consumers and the Nation's energy markets. If permitted to stand, the decisions below threaten to destabilize the regulatory framework on which thousands of wholesale power contracts are premised and to impose billions of dollars of unnecessary costs on consumers.

REASONS FOR GRANTING THE WRIT

This Court should grant *certiorari* because the decisions below contravene its own prior decisions and conflict with the decisions of every other Court of Appeals to have considered the issue. (*See* Section A, below.) If they are left uncorrected, the Ninth Circuit decisions threaten to unsettle contract stability, to inhibit much-needed investment in energy infrastructure, and to undermine the Commission's efforts to promote competition and maintain a workable, market-based rate system. Most troubling of all, they may well set the stage for future crises in the Nation's bulk power markets. (*See* Section B, below.) Finally, in greatly expanding and simultaneously blurring the circumstances in which the Commission may abrogate private contracts, the Ninth Circuit decisions have removed an important constraint on arbitrary agency decision-making. (*See* Section C, below.)

A. The Decisions Below Conflict With This Court's Controlling Authorities And Upend More Than Fifty Years Of Settled Precedent.

Over a half-century ago, this Court held in two unanimous decisions that the Federal Power Act preserves the integrity of private contracts. *See Mobile*, 350 U.S. at 347; *Federal Power Comm'n v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956). These decisions, referred to collectively as *Mobile-Sierra*, have since become towering landmarks in the regulatory jurisprudence governing domestic energy markets. The decisions recognize that because the Federal Power Act creates a regulatory system based on privately negotiated agreements, the Commission's authority to interfere with private contracts is limited. When sophisticated parties negotiate a wholesale energy contract, the agreed-on rates are presumptively "just and reasonable" and the contract may not be abrogated except in "extraordinary circumstances" of "unequivocal public necessity." *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968); *see also Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 582 (1981).

The continuing vitality of *Mobile-Sierra* has been confirmed by this Court and assumed by lower courts in a long line of cases. *See, e.g.*, *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 479 (2002); *Wisconsin Pub. Power, Inc. v. FERC*, Nos. 04-1414, *et al.*, 2007 WL 206724 (D.C. Cir. July 20, 2007); *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1 (D.C. Cir. 2002); *Northeast Utils. Serv. Co. v. FERC*, 993 F.2d 937, 960 (1st Cir. 1993). These cases have reaffirmed that, absent duress or bad faith at the time the contracts are negotiated, parties must "live with their bargains as time passes and various projections about the future are proved correct or incorrect." *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403, 410 (D.C. Cir. 2000).

Faithfully applying this well-established understanding of *Mobile-Sierra*, the Commission rejected an attempt by California and other buyers of wholesale electricity to escape contracts they had negotiated at arm's-length. The Commission found that, although "other alternatives were available," the buyers freely chose "to enter into the contracts" and knowingly accepted the market risks. Sempra Pet. App. 96a. And the Commission determined that the buyers' "dissatisfaction" with their "bargains" could not justify abrogating the contracts under the public-interest standard. *Id.* (no factor "on this record demonstrates that the contracts are contrary to the public interest").

The Commission's application of the public-interest standard was in no wise unreasonable. California and the other buyers enjoyed significant bargaining advantages and freely chose to enter the long-term contracts, which at the time they trumpeted as "fair, negotiated, hard-fought deals." Sempra Pet. 9. Although the buyers knew the Commission was taking steps to address the market's structural problems, they chose to execute the agreements, because the negotiated contract rates were well below the then-existing prices for energy on the spot market. Because the buyers had significant bargaining power, some suppliers even agreed to sell power initially "at a substantial loss in hopes of recovering those losses over the life of the contracts." Sempra Pet. 8. Perhaps most significantly, the Commission determined that, although the buyers loudly complained when spot prices later dropped, they could not "demonstrate that the contracts were priced above long-run competitive prices" or otherwise show that the contract rates exceeded just and reasonable levels. *Id.* at 10.

Reversing the Commission, the Ninth Circuit brushed aside the agency's expert determinations and recast *Mobile-Sierra* as a narrow "mode of review" that applies only in "certain limited circumstances." Sempra Pet. App. 300a-301a. Invading the province of both this Court and the Commission, the Ninth Circuit fashioned a brand new test for determining when *Mobile-Sierra*'s public-interest standard protects the integrity of contracts. *See id.* at 324a-327a. The Ninth Circuit ruled that henceforth, if a party seeks to escape its contractual obligations, *Mobile-Sierra* will not apply *unless* (1) the Commission had an opportunity to pre-approve the contract rates; and (2) the contract negotiations occurred in a market free from "dysfunction" and the influence of other "improper factors." *Id.* at 319a-320a.

Even as it narrowed its field of application, the Ninth Circuit reinvented *Mobile-Sierra*, creating a new asymmetrical standard in favor of buyers who become dissatisfied with their long-term agreements. In the Ninth Circuit's view, the public-interest standard differs depending on whether it is a seller or a buyer that is challenging a contract: When a *seller* negotiates an improvident bargain (a so-called "low rate" case), the Commission may not modify the parties' agreement unless the agreement imposes an "excessive burden" on consumers; in contrast, when a *buyer* negotiates an improvident bargain (a so-called "high rate" case), the Commission must abrogate the parties' agreement whenever "consumers' electricity bills have been affected" and the challenged rates fall outside a "zone of reasonableness." Sempra Pet. App. 326a (rates fall outside a "zone of reasonableness" if they exceed marginal costs and are not "part of a general trend toward rates that do reflect cost").

Because the Ninth Circuit's newly-fashioned test contravenes this Court's prior decisions, certiorari is warranted. *See* Sempra Pet. 3; Morgan Stanley Pet. 3; Dynegy Pet. 3-4; Calpine Pet. 2. Certiorari is also warranted because the Ninth Circuit has opened an irreconcilable conflict between its decisions below and decisions from other Courts of Appeals, including those of the First, Fifth, and D.C. Circuits. These other courts have held that Commission approval of contract rates is not a prerequisite to applying *Mobile-Sierra*. *See, e.g., Boston Edison Co. v. FERC*, 856 F.2d 361, 371 (1st Cir. 1988); *Borough of Lansdale v. FPC*, 494 F.2d 1104, 1114 (D.C. Cir. 1974); *Natural Gas Pipeline Co. of Am. v. Harrington*, 246 F.2d 915, 919 (5th Cir. 1957); *see also* Dynegy Pet. 11 (noting that the Commission's orders in *Mobile* and *Sierra* accepted, but did not approve, the contracts at issue). These courts have rejected attempts by parties to escape their contractual obligations on grounds of market dysfunction. *See* Dynegy Pet. 19-23. And they have refused to interpret *Mobile-Sierra* as establishing an asymmetrical standard that disadvantages sellers and focuses on buyers' short-term interests to the exclusion of long-term contractual stability. *See id.* at 23-26; *see also* Sempra Pet. 25-26.

In short, the Ninth Circuit has ignored settled principles of *stare decisis*, transforming the *Mobile-Sierra* public–interest standard beyond all recognition and granting the Commission unprecedented authority to abrogate contracts that might have short-term effects on retail rates. This

Court should grant review to correct the Ninth Circuit's improper exercise of judicial policymaking.

B. The Decisions Below Threaten The Public's Long-Term Interests In Reliable And Affordable Energy.

Apart from correcting the Ninth Circuit's improper departure from precedent, this Court's review is needed to prevent lasting damage to the Nation's wholesale energy markets. By making buyer's (but not seller's) remorse a basis for escaping long-term contracts, the Ninth Circuit's newly-fashioned, asymmetrical rules will discourage much-needed investment and undermine the Commission's market-based system, ultimately setting the stage for higher energy costs and less reliable energy supplies.

1. The Ninth Circuit Decisions Threaten To Destabilize Contracts And Inject Uncertainty Into The Nation's Wholesale Energy Markets.

Power markets are highly volatile and hard to predict. As commentators have noted, because power markets are susceptible to periods of inelastic demand and supply, the industry often faces large, sudden shifts in price. *See* CERA Advisory Services, *California Power Crisis Aftershock: The Potential Modification of Western Power Contracts* at 5 (April 2007) ("*Aftershock*"). These price dynamics mean that cash flows from spot markets are cyclical, unpredictable, and often insufficient to cover the full costs of power plant investments. At the same time, the capital requirements of the electric generation sector are enormous. In the next 15 years, the power sector must grow by an estimated 35 percent to keep pace with projected demand. *See id.* at 14. This expansion will require at least "$400 billion in investment in new and existing power plants." *Id.* at 15-16.

In this market environment, fixed-price, long-term contracts are an essential tool for encouraging investment in infrastructure. In particular, given the large upfront costs and long payout periods characteristic of power plant investments, long-term contracts are an important mechanism through which buyers and sellers manage risk. Long-term contracts "smooth out future cash flows for investors, reducing the cost of investments by reducing the price risk exposure and in doing so, creating savings for buyers too." *Aftershock*, at 6; *see also* Statement of Peter Rigby, Standard & Poor's Director, at 7-8, FERC Docket Nos. EL02-60-000, et al. (Mar. 20, 2002) ("Rigby Statement") (stable contracts "introduce a greater degree of stability and predictability to cash flows"). As a representative of one of the Nation's largest consumers of electric power recently explained, long-term contracts provide security to both buyers and sellers: the "seller gets the security of a long-term revenue stream with which to finance the capital costs of base load generation," while the "buyer receives the security of locking in those capital costs for the term of the contract." Comments of Walter Brockway, Conference to Examine the State of Competition in Wholesale Power Markets (May 8, 2007). Sanctity of contract thus "remains vitally important" to attracting the "capital needed to build adequate generating infrastructure." Sempra Pet. App. 242a.

It is hard to overstate the importance of regulatory certainty and contractual integrity to the efficient working of the electric power industry. *See* The Electric Energy Market Competition Task Force, *Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy*, at 74, 76-77 (April 2007) ("*Competition Report*"); *see also* William D. Bandt, et al., *Manifesto on the Cal. Elec. Crisis* (Jan. 30, 2003) (the "key to the success of an electricity market is the ability of consumers and suppliers to enter into bilateral long-term contracts"). As this Court has recognized, energy facilities "may frequently require substantial investments" that would not be made absent "long-term commitments" that, once entered, cannot be changed except in extraordinary circumstances. *Mobile*, 350 U.S. at 344. The "certainty and stability" that "stems from contract performance and enforcement" is "essential to an orderly bulk power market." *San Diego Gas & Elec. Co. v. FERC*, 904 F.2d 727, 730 (D.C. Cir. 1990). If the Commission may abrogate contracts whenever short term retail rates may be affected, "business would be transacted without legally enforceable assurances and ... the market, the industry[,] and ultimately the consumer will suffer." *Id.*

The Ninth Circuit did not address these important features of the industry. It instead took a simplistic view that subordinates "the stability of contract considerations that underlie the *Mobile-Sierra* doctrine" to advantaging buyers and insulating consumers from what the lower court described as "unjustifiably high rates." Sempra Pet. App. 325a-326a. The Ninth Circuit decisions, which are driven by an overweening concern for rates paid by consumers in the shorter term, cannot be reconciled with Congress's considered judgment that, over the longer term, consumers are better off, enjoying lower costs and more reliable energy, when the Commission respects the integrity of private contracts. *See Verizon*, 535 U.S. at 479; *see also Rodriguez v. United States*, 480 U.S. 522, 525 (1987) ("it frustrates rather than effectuates legislative intent simplistically to assume that whatever furthers the statute's primary objective must be the law").

Today, more than ever, long-term contracts are vital to promoting capital investment in the energy industry, which depends on billions of dollars to maintain and expand the infrastructure essential to providing consumers with clean, reliable, and inexpensive energy. As the Commission has noted, the "[p]reservation of contracts has, if anything, become even more critical since the [*Mobile-Sierra*] policy was first adopted." *Public Utils. Comm'n of*

Cal. v. Sellers of Long Term Contracts, 99 FERC ¶ 61,087 at 61,383 (2002). Under the traditional, cost-based regulatory system, "utility investment decisions were based in part on the promise of a regulated revenue stream with little associated risk to the utility." *Report to Congress*, at 78. Although "money from capital markets was generally available when utilities needed to fund new infrastructure," *id.*, ratepayers shouldered most of the risks of over- or under-building. The same cannot be said of today's competitive regulatory regime where markets are efficient and highly competitive. In this competitive regime, "[p]otential entrants to generation markets must be able to convince capital markets that generation is a viable profitable undertaking" and, hence, the "availability of long-term contracts ... is critical to the ability of non-utility generators to secure capital for new investment." *Id.* at 4. As highlighted by recent bankruptcies of several large merchant power developers, by write-downs of over $30 billion in generating assets, and by lender takeovers of numerous power plants, "building merchant power plants—constructed without contracts for power output or fuel inputs—has proven to be very risky." *Aftershock*, at 16. Projects without long-term contracts have rarely obtained investment-grade ratings. *See, e.g.*, Rigby Statement, at 6-7.

If the decisions below are left uncorrected, investors will need to discount the value of long-term contracts to account for the heightened, unquantifiable risk that the Commission may later modify contracts when buyers complain that rates are too high. Sophisticated investors "will not participate in a market in which disgruntled buyers are allowed to break their contracts, at least not without charging a significant risk premium—a cost that will ultimately be borne by consumers." *Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Elec. Energy by Pub. Utils.*, Proposed Policy Statement, 100 FERC ¶ 61,145 at 61,545 (2002) (Brownell and Breathitt, Comm'rs, concurring). As the Commission's Chairman recently testified, if "our energy infrastructure is inadequate, consumers are exposed to higher prices and greater price volatility." Testimony of the Hon. Joseph T. Kelliher before the Senate Energy and Natural Res. Comm., at 2 (May 10, 2007). Notwithstanding the Ninth Circuit's purported concerns for consumer welfare, its decisions threaten to harm consumers by destabilizing competitive markets and adding potentially "billions of dollars per year to the costs of the power business." *Aftershock*, at i.

The Ninth Circuit's short-sighted judicial policymaking also may hinder conservation efforts. Although vital to investment in all types of generation, reliable contracts may well be most essential to ongoing efforts to promote renewable energy sources. Numerous state-approved competitive contract solicitations require utilities to enter long-term contracts obligating them to purchase energy from plants that rely on alternative, renewable energy sources. *See Aftershock*, at 19. Similarly, investment opportunities in conservation and energy-efficient technologies are likely to rely on long-term contracts. *See id; see also* Statement of Comm'r Marc Spitzer (June 21, 2007) ("it is difficult to encourage entities to build much needed infrastructure, including fostering renewable resources, if those parties are unable to enter into enforceable long-term contracts"); FERC, Office of Markets Oversight and Investigations, *2004 State of the Markets Report*, at 232 (June 2005) ("2004 Markets Report") (describing difficulties faced by wind developers in markets where long-term contracts are unavailable). Investors will be loath to risk capital on such projects if the underlying contracts are subject to abrogation by the Commission and market solutions are replaced by court-imposed command-and-control regulation. In fact, under the Ninth Circuit's new asymmetrical rules, contracts to buy power generated from renewable sources are especially susceptible to abrogation because "technological advances are likely to dramatically reduce" the cost of such power, which could well "push the previous, existing renewable power as well as conservation and efficiency contracts" out of the court-created "zone of reasonableness." *Aftershock*, at 19.

Finally, if the Ninth Circuit decisions are not corrected, its new, asymmetrical rules will likely exacerbate future crises that might occur during periods of volatile energy prices. Sensible regulatory policies encourage market participants to hedge against market fluctuations by negotiating fixed-price, long-term contracts. Such contracts are especially important when spot market prices are volatile and unpredictable. By undermining regulatory certainty and contract stability, however, the Ninth Circuit decisions discourage market participants from negotiating long-term contracts. In fact, by requiring the Commission to invalidate contracts whenever market conditions meet some undefinable standard of "dysfunction," the Ninth Circuit has greatly complicated the negotiation of long-term contracts in precisely those circumstances in which they may be needed most. *See id.* at 20.

The Court should bear in mind that the Commission and others identified an "over reliance" on spot markets as a major cause of the California energy crisis in 2000-2001. *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,121 at 61,359 (2000); *see also* National Energy Policy Dev. Group, *Nat'l Energy Policy*, at 5-12 (May 2001) ("forcing utilities to purchase all their power through volatile spot markets, imposing a single-price auction system, and barring bilateral contracts all contributed to the problems that California now faces"); *Public Utils. Comm'n of Cal. v. Sellers of Long Term Contracts*, 103 FERC ¶ 61,354 at 62,416 (2003) (quoting the Governor of California stating that the contracts challenged in this case "should stabilize the market and drive the price of electricity down"). As the Commission's Chairman explained, one "of the lessons of the California and Western power crisis was that relying exclusively on short-term markets presents major risks to both utilities and consumers." Statement of Joseph T. Kelliher, Open Commission Meeting of the Federal Energy Regulatory Commission (Apr. 19, 2007). This is only one of the many lessons that the Ninth Circuit decisions disregard.

2. The Ninth Circuit Decisions Threaten To Prevent The Commission From Maintaining A Workable Market-Based Rate System.

Over and above their impact on contract stability, the decisions below threaten to deprive consumers of the long-term benefits of competition that Congress and the Commission have introduced into the Nation's wholesale power markets.

Although the Ninth Circuit asserted that the shift to market-based rates requires rewriting this Court's *Mobile-Sierra* decisions, Congress has taken a different approach. Congress has amended the Federal Power Act on numerous occasions, including revising it in 2005, but has consistently declined to change the public-interest standard or to expand the Commission's authority to abrogate private contracts. *See, e.g.*, *Reno v. Bossier Parish Sch. Bd.*, 520 U.S. 471, 483-84 (1997) (it is significant when Congress has failed to modify a statute in the face of a longstanding judicial interpretation); *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 496 (1989) (Stevens, J., dissenting) (it tips the "balance between judicial and legislative authority" to depart from earlier decisions giving "a statutory provision concrete meaning, which Congress elects not to amend during the ensuing 3 1/2 decades"). In fact, Congress has moved steadily in the opposite direction, recognizing that competitive energy markets offer substantial long-term benefits to consumers, including lower retail rates. As the

Commission's Chairman recently observed, the Energy Policy of Act of 2005 represents the "third major federal law enacted in the last 25 years to embrace wholesale competition." Joseph Kelliher, *Opening Remarks at the Competition in Wholesale Power Markets Conference*, FERC Docket No. AD07-7-000 (Feb. 27, 2007). Whether "competition is the correct national policy" is not an open question. *Id.*; *see also National Energy Policy*, at 5-12 (recommending that President Bush encourage the Commission "to use its existing statutory authority to promote competition"); Dep't of Energy, Energy Info. Admin., *The Changing Structure of the Elec. Power Indus. 2000: An Update*, at 63 (Oct. 2000) ("*Changing Structure*") (describing President Clinton's 1998 and 1999 Comprehensive Electricity Competition Plans as "built on the premise that a competitive electric energy market will lower prices, encourage innovation, and allow customers a choice in electric energy suppliers").

Following Congress's lead, the Commission, like other federal and state policymakers, has implemented initiatives designed to correct inefficiencies inherent in the command-and-control model of regulation favored by the Ninth Circuit. These pro-competitive initiatives have yielded significant benefits to consumers. Studies suggest that consumers have saved an estimated $34 billion in electricity costs between 1989 and 1996 as a result of Commission policies favoring market-based rates. *See Aftershock*, at 24. Most importantly, the Commission's balanced, market-based regime has facilitated investment in energy infrastructure and broader participation in energy markets. As of April 1, 2006, the Commission had granted market-based rate authority to approximately 1,170 diverse entities, including 390 independent power marketers, 100 power marketers affiliated with traditional utilities, 180 independent power producers, 400 power producers affiliated with traditional utilities, and 30 financial institutions.

See Competition Report, at 35. The emergence of this new and more flexible power industry, including power marketers and financial institutions, has "improved the industry's ability to address credit issues, increased the ability of companies to buy and sell energy, and increased market liquidity." *2004 Markets Report*, at 64. The Commission's balanced, pro-competitive policies have also facilitated the development of organized, bid-based markets, which have "created significant savings for electricity buyers." ISO/RTO Council, *The Value of Independent Reg'l Grid Operators* at 25 (Nov. 2005); *see also Competition Report*, at 31. A recent study estimates a net savings to consumers of $1.2 million *per day* in portions of the East and Midwest where bid-based markets have been established. *See* Scott M. Harvey, et al., LECG LLC, *Analysis of the Impact of Coordinated Elec. Mkts. on Consumer Elec. Charges*, at 1 (Nov. 20, 2006).

The Ninth Circuit decisions threaten to undo these accomplishments. Its new, asymmetrical rules will make it difficult for the Commission to manage a workable, market-based rate regime. Even if it seeks to cabin the Ninth Circuit decisions as limited to their facts, the Commission cannot unilaterally repair the damage because uncertainty will continue to loom over the industry as reviewing courts wrestle with the inter-circuit split and disappointed litigants maneuver for Ninth Circuit review. In fact, the new authority granted to the Commission by the Ninth Circuit has already spawned challenges to billions of dollars of power contracts. *See, e.g.*, Compl. by The People of The State of Ill., Ex Rel. Ill. Attorney General Lisa Madigan, Docket No. EL07-47-000 (Mar. 15, 2007); Section 206 Compl., FERC Docket No. EL07-50-000 (Mar. 26, 2007); Section 206 Compl., FERC Docket No. EL07-49-000 (Mar. 16, 2007); Section 206 Compl., FERC Docket No. EL07-40-000 (Mar. 2, 2007); Section 206 Compl., FERC Docket No. EL07-37-000 (Feb. 22, 2007).

More significantly, the regulatory uncertainty created by the Ninth Circuit's asymmetrical rules may well drive contracting parties back toward the relative certainty afforded by cost-based rates. *See* Statement of Jim Wells, Director National Resources and Environment, *Meeting Energy Demand in the 21st Century*, GAO-05-414T, at 7-8 (Mar. 16, 2005) ("[e]nergy suppliers require clear signals regarding national policies and confidence that those policies will be sustained over time"). Such a move threatens, among other things, the viability of competitive, bid-based markets, which depend on the certainty provided by a prior grant of general Commission authorization to transact at market-based rates. *See Changing Structure*, at 63. Even if one could ignore the potentially billions of dollars in benefits that would be lost by a retreat from competition, there is no ignoring the substantial costs such a retreat would impose on consumers. *See, e.g., S&P Warns That Re-Regulating Utilities Is Like Trying To Put Toothpaste Back In The Tube*, 502 Foster Elec. Report 10 (Apr. 11, 2007).

C. The Decisions Below Remove An Important Constraint On Arbitrary Agency Action.

By rewriting *Mobile-Sierra*, the Ninth Circuit has not only substituted its views for those of the expert Commission, it also has (somewhat paradoxically) eliminated an important constraint on arbitrary agency decisionmaking. For decades, *Mobile-Sierra* framed the boundaries of permissible Commission action, ensuring that the public interest is adequately protected, while imposing carefully prescribed limits on the Commission's authority to abrogate privately negotiated agreements. *See, e.g., Public Serv. Comm'n of N.Y. v. FPC*, 543 F.2d 757, 797 (D.C. Cir. 1974). Until the decisions below, courts deferred to the Commission's special expertise in deciding when abrogating a contract may be required in the public interest, *see* Sempra Pet. 26-

28, but did not allow the Commission to exceed the scope of its authority.

The system has worked well. When the Commission has determined that contracts contravene the public interest, its decisions have been upheld. *See, e.g. Arizona Corp. Comm'n v. FERC*, 397 F.3d 952 (D.C. Cir. 2005); *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 709-12 (D.C. Cir. 2000); *Texaco, Inc. v. FERC*, 148 F.3d 1091, 1096-97 (D.C. Cir. 1998); *Northeast Pub. Util. Comm'n v. FERC*, 55 F.3d 686 (1st Cir. 1995). Similarly, until now, courts have, *without exception*, affirmed Commission orders withholding relief where it found that contract modification was not in the public interest. *See e.g.*, *Permian*, 390 U.S. at 820-22; *Wisconsin Pub. Power*, slip op. at 57-61; *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403 (D.C. Cir. 2000); *Metropolitan Edison Co. v. FERC*, 595 F.2d 851 (D.C. Cir. 1979). It is indisputable that the Commission retains "plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." *Permian*, 390 U.S. at 784. But there is an important difference between protecting the public and abrogating contracts for the benefit of particular constituents. When the Commission has lost sight of the public interest, courts have not hesitated to "remind" the Commission that "it is not free to ignore" this Court's decisions in *Mobile-Sierra*. *Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998, 1005 (D.C. Cir. 1975).

The Commission's reluctance, in the face of the Ninth Circuit decisions, to defend the *Mobile-Sierra* doctrine is therefore not entirely unexpected. The Commission has a longstanding, well-documented record of ambivalence toward *Mobile-Sierra*. *See, e.g., Boston Edison Co. v. FERC*, 233 F.3d 60, 68 (1st Cir. 2000) (the Commission is "becoming hostile to *Mobile-Sierra*"); *Rayburn*, 515 F.2d at 1005 (the Commission's "distaste for the *Mobile-Sierra* doctrine is well known"); *Lansdale*, 494 F.2d at 1110 (the Commission "very much dislikes the *Sierra Mobile* doctrine"). This ambivalence is presumably the product, at least in part, of the agency's institutional interest in being liberated from the statutory constraints that *Mobile-Sierra* recognizes. *See, e.g.*, David B. Spence & Frank Cross, *A Public Choice Case for the Administrative State*, 89 Geo. L.J. 97, 113 (2000) ("when an agency must make decisions about the reach of its own jurisdiction, self-interest propels the agency toward ever more expansive interpretations of the law"); *cf. Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374-75 (1986) (an "agency may not ... expand its power in the face of a congressional limitation on its jurisdiction").

Finally, the Court should recognize that the Ninth Circuit decisions remove an important barrier protecting the Commission from improper political pressures. *Cf. D.C. Fed'n of Civic Assoc. v. Volpe*, 459 F.2d 1231, 1245-46 (D.C. Cir. 1972) (agency decisions based on political pressures are invalid). In these proceedings, for example, the Commission has faced an unprecedented degree of purely political pressure to ignore this Court's precedents and interfere with the arm's-length agreements negotiated by the sophisticated contracting parties involved. *See, e.g.*, Ltr. to FERC Chairman Patrick H. Wood III from U.S. Sens. M. Cantwell, G. Smith, H. Reid, R. Wyden, B. Boxer, and D. Feinstein, Docket Nos. EL02-28-000, et al. (Oct. 29, 2003) ("writing in support of requests for rehearing by the complainants"); Ltr. to FERC Chairman Patrick H. Wood III from U.S. Sen. John Kerry, Docket Nos. EL00-95-045, et al. (Apr. 23, 2003) (urging the Commission to "support the State's efforts to renegotiate the long-term energy contracts"); *see also* U.S. Sen. Dianne Feinstein, Press Release, Senator Feinstein Statement on FERC Ruling By U.S. Ninth Circuit Court of Appeals (Dec. 20, 2006). The even-handed, market-based system that has generated significant benefits to consumers will undoubtedly suffer if the Commission is empowered to look beyond the public interest and put a regulatory thumb on buyers' side of the scale whenever buyers become dissatisfied with the contract rates they have freely negotiated.

* * *

The Federal Power Act establishes a regulatory system founded on private contracts. That system, as recognized in the *Mobile-Sierra* line of cases, operates for the benefit of both the public and the Commission. The Ninth Circuit decisions unwisely depart from binding precedent, create an uneven standard in favor of buyers, and threaten to upend the stability of long-term contracts on which this Nation's energy markets depend. The lower court's disruptive, short-sighted decisions should not be allowed to stand.

CONCLUSION

For the foregoing reasons, the Court should grant the writ of *certiorari*.

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In the Supreme Court of the United States

MICHAEL GEDDES AND KARI GEDDES,
INDIVIDUALLY AND AS PARENTS AND GUARDIANS OF
ANDREW GEDDES, A MINOR CHILD, PETITIONERS

v.

UNITED STAFFING ALLIANCE
EMPLOYEE MEDICAL PLAN, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT*

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether a benefit denial under a medical plan governed by the Employee Retirement Income Security Act, 29 U.S.C. 1001 *et seq.*, should be reviewed under a deferential standard of review where the plan grants the named fiduciary discretionary authority to decide benefit claims, but a non-fiduciary agent with no discretionary authority makes the final benefit decision.

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UNITED STAFFING ALLIANCE
EMPLOYEE MEDICAL PLAN, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT*

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's invitation to the Solicitor General to express the views of the United States. In the view of the United States, the petition should be held pending this Court's decision in *MetLife* v. *Glenn*, No. 06-923 (argued Apr. 23, 2008), and then disposed of accordingly. In the alternative, the petition should be denied.

STATEMENT

1. The Employee Retirement Income Security Act (ERISA), 29 U.S.C. 1001 *et seq.*, was enacted to "protect * * * the interests of participants in employee benefit plans and their beneficiaries * * * by establishing standards of conduct, responsibility, and obligation for fiduciaries of [those] plans" and to "provide[] for appro-

priate remedies, sanctions, and ready access to the Federal courts." 29 U.S.C. 1001(b). ERISA protects the interests of plan participants and beneficiaries by requiring each plan to "provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan." 29 U.S.C. 1102(a)(1). ERISA, like traditional trust law, imposes strict duties of loyalty, prudence, and care on fiduciaries. 29 U.S.C. 1104(a)(1)(A) and (B).

Those strict fiduciary duties apply not only to named fiduciaries, but to any others who serve as fiduciaries. For example, a plan may authorize a named fiduciary to "designate persons other than named fiduciaries to carry out fiduciary responsibilities." 29 U.S.C. 1105(c)(1)(B). Such persons are themselves considered fiduciaries with respect to the plan. 29 U.S.C. 1102(21)(A) (final sentence). In addition, those not named as fiduciaries in the plan or designated by the named fiduciary are nonetheless considered fiduciaries if, *inter alia*, they "ha[ve] any discretionary authority or discretionary responsibility in the administration of such plan." 29 U.S.C. 1002(21)(A)(iii).

ERISA authorizes a plan participant or beneficiary to bring a civil action "to recover benefits due to him under the terms of his plan." 29 U.S.C. 1132(a)(1)(B). In *Firestone Tire & Rubber Co.* v. *Bruch*, 489 U.S. 101 (1989), this Court considered the appropriate standard of review in a suit for benefits. *Id.* at 108. Noting that Congress did not specify a standard, the Court turned to the purposes of ERISA and its basis in trust law. *Id.* at 108-115. The Court observed that "settled principles of trust law * * * point to *de novo* review of benefit eligibility determinations based on plan interpretations." *Id.*

at 112. But the Court also noted that "[t]rust principles make a deferential standard of review appropriate when a trustee exercises discretionary powers," and in that situation a trustee's actions "will not be disturbed if reasonable." *Id.* at 111. The Court thus concluded "that a denial of benefits challenged under § 1132(a)(1)(B) is to be reviewed under a *de novo* standard unless the benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan," in which case abuse-of-discretion review applies. *Id.* at 115.

2. a. In June 2002, petitioners' son Andrew suffered a severe spinal cord injury during a trip to Lake Powell, Utah. He was taken by air ambulance to St. Mary's Hospital in Grand Junction, Colorado, where he underwent spinal cord surgery. He remained in intensive care for two weeks, with a halo device screwed to his skull to prevent his spinal cord from moving. Pet. App. 2a-3a.

Andrew was then transferred to Primary Children's Hospital in Salt Lake City, Utah. He arrived wearing the halo apparatus, catheterized, attached to an intravenous drip, and with splints on his arms and legs. Andrew's primary treating physician recommended two months of in-patient treatment, which included pain control, bowel and bladder treatment, medication for infectious disease, and rehabilitation. That treatment, according to Andrew's doctor, was medically necessary and typical for patients in Andrew's condition. Andrew remained at Primary Children's Hospital for approximately two months. Pet. App. 3a.

b. At the time of his accident, Andrew was a covered dependent under the United Staffing Alliance Employee Medical Plan (Plan), an ERISA health benefit plan sponsored by his father's employer, respondent U.S.A.

United Staffing Alliance, L.L.C. (United Staffing). Pet. App. 3a-4a.

The Plan designated United Staffing as named fiduciary and plan administrator, and it provided that United Staffing would engage an independent third-party administrator to review claims and administer benefits. Pet. App. 4a. United Staffing chose Everest Administrators (Everest) as its third-party administrator. *Ibid.* Everest, in turn, utilized Intracorp, another third-party administrator, to make medical necessity determinations. *Id.* at 38a; Pet. C.A. Br. 7.

Although the Plan authorized use of a third-party claims administrator, it stated that United Staffing "will have the responsibility to make all final determinations regarding claims for benefits under the Plan, and will have the right to interpret the terms and provisions of the Plan." Pet. App. 46a. Further, United Staffing's contract with Everest stated that Everest "shall not be deemed a plan 'fiduciary' as defined in ERISA"; that Everest's "services shall not include any power to make decisions regarding Plan policy, * * * but shall be confined to ministerial functions"; and that Everest "shall have no final discretionary control over Plan management." *Id.* at 30a-31a (Holloway, J., dissenting).

Petitioners submitted a claim for Andrew's treatment at Primary Children's Hospital. Pet. App. 4a. Everest had Intracorp make a medical necessity determination regarding the claim, and then denied the claim. *Ibid.*; Pet. C.A. Br. 7. On a standard claim denial form, Everest stated that the claim was denied because it was for in-patient rehabilitation, and the Plan imposed a $2500 yearly cap on that type of care. Pet. App. 4a, 41a. As a result, the Plan paid only a small portion of the $99,432 cost of Andrew's stay. *Id.* at 4a, 40a-41a.

Petitioners received a letter that appeared to be from both Everest and Intracorp inviting them to appeal the benefit denial by contacting an appeals coordinator at Intracorp. Pet. App. 41a-42a. Petitioners sent an appeal letter to Intracorp. *Id.* at 42a. Everest later sent a letter to petitioners' attorney denying petitioner's "request for reconsideration" because, although Everest "completely agree[d] that the rehabilitation care was medically necessary," "[l]imits on long-term rehabilitation care are almost universal." *Id.* at 4a-5a, 41a-43a.[1]

3. Petitioners filed suit under 29 U.S.C. 1132(a)(1)(B), and the district court reversed the benefit denial. Pet. App. 35a-65a. The court determined that the benefit denial should be reviewed *de novo*, rather than under a deferential standard of review. *Id.* at 43a-53a. Relying on *Firestone*, the court explained that, "[t]o be entitled to deferential review, not only must the administrator be given discretion by the plan, but the administrator's decision in a given case must be a valid exercise of that discretion." *Id.* at 44a (internal quotation marks omitted).

Here, the court explained, neither United Staffing nor Everest exercised any discretion in denying the claim. Pet. App. 43a-53a. The court noted that the United Staffing-Everest contract stated, and "all parties agreed," "that Everest * * * was not a fiduciary and had no fiduciary duties to [petitioners]." *Id.* at 45a. The court then found that "there is no evidence that United Staffing ever reviewed any of [petitioners'] claims." *Ibid.* Indeed, United Staffing's owner testified that United Staffing "[n]ever ha[s]" "s[at] down and review[ed] a claim from a plan participant to determine whether the claim is going to be covered," because that is "Everest's responsibility." *Id.* at 39a.

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[1] The Plan also paid less than half of the cost of Andrew's treatment at St. Mary's Hospital, based on Everest's view that the "usual and customary amount" that the Plan would pay for out-of-network treatment was the same as the rate it negotiated with in-network doctors. Pet. App. 4a, 17a-18a. The district court overturned that ruling on *de novo* review as contrary to industry practice and unreasonable. *Id.* at 54a-59a. The court of appeals affirmed under arbitrary-and-capricious review, *id.* at 17a-21a, and that claim is not at issue here.

Utilizing *de novo* review, the district court determined that United Staffing erred in concluding that the entire stay at Primary Children's Hospital was for rehabilitative purposes. Pet. App. 59a-62a. The court explained that Everest "did not review the medical records and instead simply relied upon billing codes on invoices to determine whether to pay benefits," and it concluded, based on the testimony of Andrew's treating physician, that most of the care at Primary Children's Hospital was medically necessary and not rehabilitative. *Id.* at 61a-62a.

4. The court of appeals reversed. Pet. App. 1a-24a. It held that the benefit denial was subject to deferential review, reasoning that "[t]o qualify their decisions for deferential review, *Firestone* requires only that ERISA health plan administrators and fiduciaries reserve discretionary authority to themselves in the plan document," and United Staffing did that here. *Id.* at 6a, 9a. In the court of appeals' view, the district court erred in holding that "United Staffing's delegation of authority to an independent claims agency * * * constitutes a failure to exercise administrative discretion, triggering *de novo* review," *id.* at 7a, because "*Firestone* does not limit the parties to whom a fiduciary may delegate its authority," *id.* at 10a. The court reasoned that "[d]ecisions made by an independent, non-fiduciary third party

at the behest of the fiduciary plan administrator are entitled to *Firestone* deference because third parties act only as agents of the fiduciary," so that "decisions made by third parties are decisions made by the fiduciary." *Id.* at 14a.

In this case, the court stated, "Everest made a benefits determination according to the procedures of the Plan, which United, as the Plan fiduciary, then accepted." Pet. App. 12a. "Thus," the court concluded, "discretion was exercised by some combination of the fiduciary and its agent." *Ibid.*

Judge Holloway dissented. Pet. App. 24a-34a. He agreed with the majority both that a named fiduciary may designate an agent "to carry out ministerial functions" and that it "may designate another fiduciary to perform discretionary duties." *Id.* at 28a. But, he observed, "to be entitled to deferential review, the administrator must actually exercise the discretion granted by the plan," and here, "[n]o party exercised th[at] discretion." *Id.* at 25a-26a. Judge Holloway also noted that the district court would be free on remand to consider an alternative basis petitioners had advanced for *de novo* review—that respondents had not followed applicable procedures governing the review of ERISA benefit claims. *Id.* at 33a n.4.

DISCUSSION

The petition is premised on the view that the court of appeals held that a benefit denial by a third-party administrator that was not granted and did not exercise any discretionary authority is subject to deferential judicial review under ERISA. If the decision below is read in that way, the court of appeals erred, because both *Firestone* and settled principles of trust law establish that *de novo* review is appropriate where no party has actually exercised discretion. To the extent the court of appeals held otherwise, it created disagreement in the circuits, because several courts of appeals have recognized that deferential review is appropriate only when a party has discretionary authority *and* actually exercises that authority.

However, the court of appeals also suggested that deferential review is appropriate because United Staffing *did* exercise its discretionary authority. See Pet. App. 12a. The undisputed factual record provides little, if any, support for such a factual finding. Nonetheless, if the decision is read in that way, it would be consistent with *Firestone*, trust law principles, and the decisions of the other courts of appeals.

Although petitioners' reading of the court of appeals' opinion is likely correct, plenary review is not warranted. There is at least some ambiguity in the opinion, and if interpreted as petitioners propose it would create an intracircuit conflict that the Tenth Circuit should be given an opportunity to resolve. Moreover, *de novo* review may ultimately be warranted in any event due to United Staffing's apparent failure to provide a full and fair review of petitioners' claim, as required by ERISA, its implementing regulations, and the Plan.

Although this case does not warrant plenary review, this Court should hold the petition pending its decision in *MetLife* v. *Glenn*, No. 06-923 (argued Apr. 23, 2008), in which the Court is considering the framework of judicial review under *Firestone*.

A. If Interpreted As Petitioners Suggest, The Decision Below Would Be Erroneous And Create A Circuit Conflict

1. The petition characterizes the decision below as holding that a ministerial decision by a non-fiduciary is subject to a deferential standard of review. Pet. 8-13. Although the opinion is not free from ambiguity, in the government's view, petitioners' is the best reading of the opinion.

The court of appeals stated that, "[t]o qualify their decisions for deferential review, *Firestone* requires only that ERISA health plan administrators and fiduciaries reserve discretionary authority to themselves in the plan document." Pet. App. 9a. It noted that, under trust law, a fiduciary may delegate its authority to an agent who is not a fiduciary, and when it does so, the fiduciary remains liable for the actions of its agent. *Id.* at 9a-11a. In the court's view, because "decisions made by third parties are decisions made by the fiduciary" "[f]or purposes of liability," "[i]f a plan administrator has been allotted discretionary authority in the plan document, the decisions of both it and its agents are entitled to judicial deference." *Id.* at 14a; see *ibid.* ("Decisions made by an independent, non-fiduciary third party at the behest of the fiduciary plan administrator are entitled to *Firestone* deference because the third parties act only as agents of the fiduciary."). The court thus appeared to adopt the following syllogism: (1) decisions of a fiduciary with discretionary authority are subject to deferential review; (2) decisions by an agent of a fiduciary are decisions of the fiduciary for liability purposes; and therefore (3) decisions by an agent who exercises no discretion are subject to deferential review.

2. If the decision below is interpreted in that manner, the court of appeals erred. The syllogism fails to account for the need for discretionary authority to be exercised in order for deferential review to be appropriate.

In *Firestone*, this Court articulated a framework for judicial review of benefit denials. Observing that ERISA "does not set out the appropriate standard of review for [such] actions," the Court turned to trust law and concluded that a benefit denial should be "reviewed under a *de novo* standard unless the benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan," in which case abuse-of-discretion review applies. 489 U.S. at 109-111, 115.[2]

Firestone makes clear that a deferential standard of review applies only when the plan confers discretionary authority on the plan administrator *and* the administrator exercises that authority. The Court recognized that if the settlor of a trust expressly confers discretionary authority on a trustee, the trustee's actions are reviewed for an abuse of discretion, so long as the trustee "*exercises* discretionary powers." 489 U.S. at 111 (emphasis added). And the Court rejected the argument that all decisions of an administrator that is a fiduciary are inherently discretionary, concluding instead that the administrator's decision receives deference only if the plan expressly conferred discretionary authority and the administrator exercised that authority. *Id.* at 112-113.

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[2] The Tenth Circuit in this case referred to deferential review as "arbitrary and capricious" review. See, *e.g.*, Pet. App. 6a, 23a. As the United States explains in its amicus brief in *MetLife* (at 29 n.3), however, that standard of review and other principles drawn from judicial review of federal agency actions are inapposite in the ERISA context. Rather, deferential review is appropriately conducted by applying a general standard of reasonableness.

Settled principles of trust law confirm that a trustee's decision is reviewed *de novo* when the trustee has discretionary authority under the terms of the trust but does not exercise that authority. As the Second Restatement of Trusts explains, "[t]he court will control the trustee in the exercise of a power where its exercise is left to the judgment of the trustee and he fails to use his judgment." Restatement (Second) of Trusts § 187 cmt. h at 405 (1959) (Second Restatement); accord Restatement (Third) of Trusts § 87 cmt. c at 244 (2007) (Third Restatement). "[W]here a trustee has discretion whether or not to make any payments to a particular beneficiary, the court will interpose if the trustee * * * fails to exercise that discretion," Third Restatement § 50 cmt. b at 261, by, for example, "refus[ing] to inquire into the circumstances of the beneficiary," 3 Austin W. Scott & William F. Fratcher, *The Law of Trusts* § 187.3 at 41 (4th ed. 1988) (Scott & Fratcher). Under those circumstances, a court may make its own judgment and order payment, Third Restatement § 50 cmt. b at 261, "even though what is done by the trustee or what he fails to do would have been proper if he had used his judgment," because "[w]here he does not use his judgment, he has not acted in the state of mind * * * contemplated by the settlor," Scott & Fratcher § 187.3 at 40-41.

3. Application of those principles to this case demonstrates that the court of appeals erred to the extent it held that deference is due a non-discretionary decision by a non-fiduciary. Under *Firestone* and settled principles of trust law, a non-discretionary decision is reviewed *de novo*, because when a trustee has not exercised his judgment, he has made no judgment call to

which a court might defer. See Pet. App. 29a (Holloway, J., dissenting).

Contrary to the court of appeals' statement (Pet. App. 9a), it is not enough for a settlor simply to confer discretionary authority on a plan administrator. Rather, discretionary authority must actually be exercised in making the benefit determination. See Second Restatement § 187 cmt. h at 405; Third Restatement § 50 cmt. b at 261, § 87 cmt. c at 244.

Those principles apply both to decisions made by a named fiduciary and decisions made by agents of a named fiduciary. The court of appeals correctly recognized that a named fiduciary may delegate both fiduciary responsibilities and ministerial functions to a third party. Pet. App. 9a-11a; see Second Restatement § 171 cmt. d at 374-375; Third Restatement § 171 cmt. f at 143-144, § 227 cmt. j at 38-40. But that proposition does not change the general rule that courts properly defer only when the fiduciary or its agent actually exercises properly delegated discretionary authority. Contrary to the court of appeals' minor premise (Pet. App. 14a), it is not enough that United Staffing, like any principal, was liable for the acts of its agent, Everest. The benefit denial must be based on an actual exercise of discretionary *judgment*. Where, as here, the named fiduciary delegated only ministerial (non-discretionary) tasks to a third party, and the third party performed only those tasks, there is no exercise of discretionary judgment to which a court could defer.

United Staffing erroneously suggests (Br. in Opp. 4-6) that ERISA mandates deferential review because 29 U.S.C. 1105(c)(1)(B) expressly authorizes a named fiduciary to delegate fiduciary responsibilities to a third party. Section 1105(c)(1)(B) does not address the standard of review in a suit for benefits, and, in any event, the delegation in this case is not of the type contemplated by that section, because the parties agreed (and the undisputed facts confirm) that United Staffing delegated only ministerial functions to Everest. See Pet. App. 8a n.1; *id.* at 30a (Holloway, J., dissenting); *id.* at 45a.

United Staffing also errs in contending (Br. in Opp. 4) that Section 1105(c)(1) permits delegation of fiduciary responsibilities to a non-fiduciary. If a claims administrator exercises discretion, it is, *by definition*, a fiduciary under ERISA, see 29 U.S.C. 1002(21)(A); Pet. App. 26a n.1 (Holloway, J., dissenting), and is subject to ERISA's strict duties of loyalty, care, and prudence, see 29 U.S.C. 1104(a)(1)(A) and (B). In return, courts review the administrator's decisions deferentially. Here, the court of appeals erred to the extent it gave deference to a third-party administrator that did *not* exercise discretion and was *not* subject to ERISA's strict fiduciary duties.

4. To the extent the Tenth Circuit's decision is read as petitioners suggest, it creates disagreement in the courts of appeals, because several circuits have correctly held that a benefit decision is reviewed *de novo* when no discretion was exercised in making the decision. For example, a number of courts have held that *de novo* review applies when a fiduciary had discretionary authority but failed to delegate (or properly delegate) that authority to the decisionmaker. See, *e.g.*, *Shane* v. *Albertson's Inc.*, 504 F.3d 1166, 1170-1171 (9th Cir. 2007); *Sanford* v. *Harvard Indus.*, 262 F.3d 590, 596-597 (6th Cir. 2001); *Rodriguez-Abreu* v. *Chase Manhattan Bank, N.A.*, 986 F.2d 580, 583-584 (1st Cir. 1993). In addition, as the court of appeals recognized (Pet. App. 13a), the

Eleventh Circuit has held that *de novo* review applies when an agent performs entirely administrative functions and does not exercise any discretionary authority in determining plan benefits. See *Baker* v. *Big Star Div. of the Grand Union Co.*, 893 F.2d 288, 290-292 (1989). In that case, the named fiduciary delegated the initial benefit decisions to a third-party administrator, limited the third-party administrator to non-discretionary decisions, and reserved final decisionmaking authority. *Ibid.* Because the decisionmaker did not exercise any discretionary authority, no deference was due. *Id.* at 291-292.[3]

If read as petitioners urge, the decision below would conflict with *Baker* and be in significant tension with *Shane*, *Sanford*, and *Rodriguez-Abreu.* In each of those cases, as in this case, there was no delegation of fiduciary responsibility over benefits determinations to the party that decided the claim, and as a result, the decisionmaker lacked discretionary authority. See, *e.g.*, *Shane*, 504 F.3d at 1170-1171; *Sanford*, 262 F.3d at 596;

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[3] Contrary to United Staffing's contention (Br. in Opp. 8), the Eleventh Circuit has not abandoned the reasoning of *Baker*, and other courts have not deemed it an "anomaly." The Eleventh Circuit's decision in *Kirwan* v. *Marriott Corp.*, 10 F.3d 784, 789 (1994), concerned a plan that failed to confer discretionary authority on the administrator. The other cases cited by United Staffing either agree with *Baker* or address different issues. See *Briscoe* v. *Fine*, 444 F.3d 478, 489-490 (6th Cir. 2006) (agreeing with *Baker* that third-party administrator without discretionary authority was not a fiduciary); *Bouboulis* v. *Transport Workers Union of Am.*, 442 F.3d 55, 65 (2d Cir. 2006) (in contrast to *Baker*, plan administrator granted discretionary authority under plan was a fiduciary); *Brown* v. *Blue Cross & Blue Shield*, 898 F.2d 1556, 1562-1563 (11th Cir. 1990) (addressing how to weigh conflict of interest in abuse-of-discretion review, an issue not raised in *Baker*), cert. denied, 498 U.S. 1040 (1991).

Rodriguez-Abreu, 986 F.2d at 584; *Baker*, 893 F.2d at 290-292. But while those courts applied *de novo* review, the court below did not, stating instead that deference is due simply because the named fiduciary has discretionary authority.[4]

B. Under Another Possible Interpretation, The Decision Below Would Be Limited To Its Facts

Although petitioners appear to have the better reading of the decision below, there is one statement in the opinion that creates ambiguity and suggests that the opinion could be read to hold that deferential review is appropriate because United Staffing actually exercised discretion. In justifying deferential review, the court of appeals noted its prior decision in *Gilbertson* v. *Allied Signal Inc.*, 328 F.3d 625 (10th Cir. 2003), which "held that a plan administrator must actually exercise the discretion the *Firestone* language confers in order to enjoy deferential review of its decisions." Pet. App. 7a. The court then later distinguished *Gilbertson* on the ground that it involved a claim that was "deemed denied" because a plan administrator failed to review it, where as here, "Everest made a benefits determination according to the procedures of the Plan, which United, as the Plan fiduciary, then accepted." *Id.* at 12a. "Thus," the court stated, "unlike in *Gilbertson*, discretion was exercised by some combination of the fiduciary and its agent." *Ibid.* To the extent that the court of appeals held that deferential review applied because United Staffing, which had been granted discretionary authority under the Plan, *id.* at 4a, 6a-7a, actually exercised that authority in this case, the decision below would not state an erroneous legal principle or conflict with *Firestone* or the decisions of other circuits.

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[4] Petitioners also contend (Pet. 12-13) that the decision below conflicts with *Madden* v. *ITT Long Term Disability Plan for Salaried Employees*, 914 F.2d 1279 (9th Cir. 1990), cert. denied, 498 U.S. 1087 (1991). That case does not present a square conflict because there the named fiduciary properly delegated fiduciary authority to an agent who exercised that authority, making deferential review appropriate, *id.* at 1283-1285, and here there was no such delegation. *Madden* does, however, repeat the general rule that deferential review is appropriate only when an agent actually exercised properly delegated discretionary authority. *Ibid.*

Although such a holding would reflect a correct statement of law, it would be difficult to sustain on the undisputed facts of this case. The district court concluded that neither Everest nor United Staffing actually exercised discretion. It noted that the contract between United Staffing and Everest explicitly stated (and all parties agreed) that Everest was not a fiduciary and could perform only ministerial functions. Pet. App. 45a; see *id.* at 30a-31a (Holloway, J., dissenting). Accordingly, Everest did not have any discretion to exercise. The deposition testimony of an Everest official confirmed that it was "not the case" that Everest made "some sort of judgment decision" in denying benefits; instead, Everest decided whether to pay benefits by reading the numerical code used by the hospital on its bill and comparing that billing code to the schedule of benefits in the plan. *Id.* at 59a-60a; see *id.* at 31a-33a (Holloway, J., dissenting).

The district court also concluded that United Staffing failed to exercise the discretion it actually possessed in denying benefits, noting that "there is no evidence that United Staffing ever reviewed any of [petitioners'] claims." Pet. App. 45a. The court also recounted the testimony of United Staffing's owner, who agreed that "United Staffing never sits down and reviews a claim";

that United Staffing has never been involved in the appeal process for any claim; and that United Staffing did not know "any of the specifics" about petitioners' claims. *Id.* at 51a; see *id.* at 38a-39a. Finding "no evidence suggesting that the Plan Administrator here (United Staffing) actually made the decision to deny [petitioners'] claim," the district court concluded that there was no exercise of discretion to which a reviewing court could defer. *Id.* at 45a, 51a-53a.

The court of appeals did not discuss in any detail these assessments of the record or the conclusions the district court drew based on them. Instead, it stated simply that United Staffing "accepted" Everest's benefit determination and, "[t]hus," that "discretion was exercised by some combination of the fiduciary and its agent." Pet. App. 12a. That statement does not necessarily mean that the court of appeals concluded that United Staffing actually exercised discretion by reviewing the facts of petitioners' claim and interpreting and applying the Plan's terms. The word "accepted" is consistent with the quite different understanding—strongly supported by the record—that United Staffing passively acceded to Everest's determination, with no independent analysis. Other portions of the court of appeals' opinion suggest that the court believed that the mere acceptance of Everest's determination by United Staffing could be regarded as discretionary because United Staffing was a fiduciary vested with discretionary authority and had made a discretionary decision to delegate authority—albeit only ministerial authority—to Everest. See *id.* at 9a, 11a-12a. As explained above, that is incorrect, because in that event discretionary judgment would not actually have been exercised by *anyone* with respect to petitioners' particular claim.

In sum, to the extent that the court of appeals meant to say that United Staffing actually *did* exercise discretion in the relevant sense—by reviewing the facts of petitioners' claim and interpreting and applying the Plan's terms to that claim—such a holding would appear to have little (if any) support in the record. See *id.* at 28a n.3 (Holloway, J., dissenting). Nonetheless, any error in such a conclusion would be fact-bound error that would be limited to this particular case and would not warrant this Court's review. See Sup. Ct. R. 10; *United States* v. *Johnston*, 268 U.S. 220, 227 (1925).

C. The Question Presented Does Not Warrant Plenary Review At This Time

If the decision below is interpreted as petitioners contend, that decision, as explained above, would be incorrect, contrary to this Court's decision in *Firestone*, in conflict with the Eleventh Circuit's decision in *Baker*, and in substantial tension with decisions of several other courts of appeals. Nonetheless, plenary review is unwarranted for two reasons.

1. As the court of appeals noted (Pet. App. 7a), it previously held in *Gilbertson* that the decision of an administrator who had discretionary authority but did not exercise that authority should be reviewed *de novo*. In particular, the *Gilbertson* court stated that "*Firestone* establishes *de novo* review as the default standard for reviewing ERISA claims, with deferential review only in those instances where an administrator's decision is an exercise of 'a discretion vested in them by the instrument under which they act.'" 328 F.3d at 631 (quoting *Firestone*, 489 U.S. at 111). "Therefore," the court stated, "to be entitled to deferential review, not only must the administrator be given discretion by the plan,

but the administrator's decision in a given case must be a valid exercise of that discretion." *Ibid.*

Although the court of appeals attempted to distinguish *Gilbertson*, Pet. App. 7a-14a, the decision below appears to be in substantial tension with that case if read as petitioners contend. It would be appropriate for this Court to allow the Tenth Circuit to reconcile those two decisions, especially if subsequent decisions undermine the correctness of petitioners' reading and thus the tension between *Gilbertson* and the decision below. See, *e.g.*, *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957) (per curiam). If it does so, any circuit conflict may abate, because the decision below is the only court of appeals decision that appears to have announced a rule of deference in these circumstances.

2. Furthermore, resolution of the question presented may not ultimately affect the standard of review in this case. Petitioners argued below that *de novo* review is appropriate for the additional reason that United Staffing failed to provide a full and fair review of their claim. Pet. Summ. J. Mem. 11-17; Pet. C.A. Br. 8-9, 17 n.9, 24-28. Although neither the district court nor the court of appeals addressed that argument, Pet. App. 52a-53a; *id.* at 33a n.4 (Holloway, J., dissenting), it appears to have considerable merit.

The undisputed factual record reveals a clear failure to provide the full and fair review mandated by ERISA, the Secretary of Labor's regulations, and the Plan. ERISA requires every plan to "provide adequate notice in writing" of any benefit denial, "setting forth the specific reasons for such denial," and to "afford a reasonable opportunity * * * for a full and fair review by the appropriate named fiduciary of the decision denying the claim." 29 U.S.C. 1133. The Secretary of Labor has promulgated detailed regulations setting out the minimum procedures necessary for that full and fair review. See 29 C.F.R. 2560.503-1(g), (h), and (j). They require, *inter alia*, that a plan "[p]rovide for a review that does not afford deference to the initial adverse benefit determination and that is conducted by an appropriate named fiduciary of the plan who is neither the individual who made the benefit determination * * * nor the subordinate of such individual." 29 C.F.R. 2650.503-1(h)(3)(ii).[5] To implement those requirements, the Plan mandates "*written* notice of any claim that is denied," and it provides that United Staffing "will have the responsibility to make all final determinations regarding the claims for benefits under the Plan." Pet. App. 38a.

Despite the requirement under ERISA, the Secretary's regulations, and the Plan that any appeal be reviewed by a named fiduciary, United Staffing (the named fiduciary) acknowledged that it never reviewed Everest's denial of benefits, and that its standard practice was not to review *any* benefit denials. Pet. App. 51a-52a. The courts of appeals have recognized that *de novo* review is appropriate when the named fiduciary fails substantially to provide the full and fair review required by ERISA and the Secretary's claims regulations, because the named fiduciary's actions—even when granted discretion to interpret the plan and make benefit determinations—must be within the limits of the governing law, ERISA, which mandates a full and fair review. See, *e.g.*, *Abatie* v. *Alta Health & Life Ins. Co.*, 458 F.3d 955, 971-972 (9th Cir. 2006). Indeed, the Tenth Circuit adopted that principle in *Gilbertson*. 328 F.3d at 635.

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[5] That regulation applies to "claims filed on or after the first day of the first plan year beginning on or after July 1, 2002, but in no event later than January 1, 2003." 66 Fed. Reg. 35,886 (2001). It is unclear whether the claim at issue here was filed during a plan year beginning on or after July 1, 2002. In any event, the previous version of the regulation also contained the requirement of full and fair review by "an appropriate named fiduciary or to a person designated by such fiduciary." 29 C.F.R. 2560.503-1(g)(1) (2000).

Although this issue appears to have been adequately raised on appeal (see p. 19, *supra*), the court of appeals did not address it, and the court remanded to the district court for reconsideration under a deferential standard of review. See Pet. App. 23a. Judge Holloway, however, expressed the view that the district court would be free to address the full-and-fair-review issue on remand. *Id.* at 33a n.4. Judge Holloway's view that the issue remains open on remand is consistent with the fact that the majority reversed the district court's grant of summary judgment in favor of petitioners, which had been entered on the separate ground at issue in the question presented without reaching petitioners' alternative argument concerning respondents' failure to follow the required claims procedures. See Pet. App. 52a-53a.

D. The Petition Should Be Held Pending The Decision In *MetLife* v. *Glenn*

In *MetLife* v. *Glenn*, No. 06-923 (argued Apr. 23, 2008), this Court is currently considering the appropriate standard of review when a plan confers discretionary authority on an administrator who is operating under a conflict of interest. Petitioners have not argued that *de novo* review is appropriate on that basis. See Pet. C.A. Br. 12 n.5. Nonetheless, to the extent that the Court in *MetLife* refines the framework for judicial review of benefit denials under *Firestone*, further consideration of this case in light of the decision in *MetLife* would be appropriate. The Court therefore should hold the petition pending its decision in *MetLife*. If this Court then vacates and remands the court of appeals' decision in this case, the court of appeals would be free on remand to reconsider its decision in light of views of the Secretary of Labor expressed herein, which it has not previously solicited or considered. The court of appeals could also clarify the precise basis for its decision and take into account petitioners' argument concerning respondents' failure to follow applicable claims procedures, which may have substantially contributed to the apparent failure by United Staffing to exercise any discretion in reviewing petitioners' claim.

CONCLUSION

The petition for a writ of certiorari should be held pending this Court's decision in *MetLife* v. *Glenn*, No. 06-923, and then disposed of accordingly. In the alternative, the petition should be denied.

Respectfully submitted.

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Nos. 06-1454, 06-1457, 06-1462, and 06-1468

In the Supreme Court of the United States

SEMPRA GENERATION, *et al.*, and
DYNEGY POWER MARKETING, INC., *et al.*,
Petitioners

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *et al.*,
Respondents

MORGAN STANLEY CAPITAL GROUP INC. and
CALPINE ENERGY SERVICES, L.P., *et al.*,
Petitioners

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY
WASHINGTON, *et al.*, and
FEDERAL ENERGY REGULATORY COMMISSION,
Respondents

**On Petitions for a Writ of Certiorari to the
United States Court of Appeals for the Ninth Circuit**

BRIEF OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., AND THE FINANCIAL INSTITUTIONS ENERGY GROUP AS *AMICI CURIAE* SUPPORTING PETITIONERS

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BRIEF OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., AND THE FINANCIAL INSTITUTIONS ENERGY GROUP AS *AMICI CURIAE* SUPPORTING PETITIONERS

INTEREST OF THE *AMICI CURIAE*[1]

The International Swaps and Derivatives Association, Inc. (ISDA), is the largest financial trade association in the world, representing leading participants in the privately negotiated derivatives industry. It was chartered in 1985, and includes more than 780 member institutions from 54 countries on six continents. These members include most of the world's major institutions that deal in, and are leading end users of, privately negotiated derivatives, as well as many of the businesses, governmental entities, and other end users that rely on derivatives to manage efficiently the financial market risks inherent in their core economic activities. Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business.

The Financial Institutions Energy Group (FIEG) is a group of investment and commercial banks and other financial institutions, all of which play a vital role in the electric utility industry. The businesses of FIEG members (and their affiliates) as they relate to the energy sector are very diverse. They are directly involved in the purchase and sale of electric energy, capacity, and ancillary services, and many are power marketers with market-based rate authority. They are also involved in a wide array of other businesses that are only incidentally related to the electric industry. For example, FIEG members may act as market-making dealers, participants in physically and financially settled derivative transactions designed to hedge certain counterparty risk or to establish a proprietary position in the market, arrangers of loan facilities, and underwriters of debt and equity securities.

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[1] The parties' letters of consent to the filing of this brief have been lodged with the Clerk. Pursuant to Rule 37.6 of the Rules of this Court, *amici curiae* state that no counsel for a party has written this brief in whole or in part and that no person or entity other than the *amici curiae*, their members, or their counsel has made a monetary contribution to the preparation or submission of this brief.

Members of ISDA and FIEG are substantial participants in the market for wholesale electric power sales. Some of those members own interests in companies that produce electric power and sell it in the wholesale market. Some own interests in companies that purchase electric power in the wholesale market and distribute it to end users. And some are not involved in either the production or the retail distribution of electric power, but participate as traders that buy and sell power in transactions with producers, retail distributors, and other traders. ISDA and FIEG do not have an institutional interest to promote legal rules that systematically favor either buyers or sellers of electric power. Rather, *amici* seek to promote legal rules necessary to ensure a vibrant and efficient *market* for electric power, which will benefit all market participants – both buyers and sellers – and, indirectly, end users of electricity, whose interests are served by the efficient production and distribution of electric power.

This interest in a vibrant and efficient market is threatened by the Ninth Circuit's decisions in these cases. Clear, stable, and enforceable rules governing contracts are essential for any market to function effectively, and are especially important in the market for electric power, which depends on long-term investments and contractual sales involving hundreds of billions of dollars every year. For more than half a century, decisions of this Court have protected the legitimate economic expectations of participants in this market, by making clear that, when parties choose to enter into a contract to buy or sell power, their agreement will be enforced even if, in hindsight, the agreement turned out to be unfavorable to one or more contracting parties. The Ninth Circuit's decisions are fundamentally at odds with that principle. Because of their members' unique role in this market, *amici* are well positioned to explain why the Ninth Circuit's decisions, if allowed to stand, will lead to market dysfunction that will impose enormous costs on the American public.

SUMMARY OF ARGUMENT

Unless corrected, the Ninth Circuit's decisions will cause serious harm to the market for wholesale electric power. That market is extraordinarily important to the Nation's economy. End users spend about $300 billion annually to purchase electricity, and much of that power is purchased in a vibrant wholesale market that has developed over the past decade. In addition to producers and retail distributors of power, participants in this wholesale market include many firms that principally operate as traders. Their presence has enhanced market liquidity and transparency, and has permitted producers and distributors to reduce their exposure to financial risk by using contractual arrangements that shift risk to traders with greater expertise in risk management.

It is essential for those traders, and for other market participants, to be able to rely on the integrity and enforceability of contracts. That need has been served for more than half a century by the *Mobile-Sierra* doctrine, which prevents the regulatory abrogation of contracts in all but the most extraordinary circumstances. The Ninth Circuit's decisions, while purporting to apply that doctrine, effectively overrule it.

The Ninth Circuit held that the *Mobile-Sierra* doctrine cannot be invoked unless the Federal Energy Regulatory Commission (FERC) had an initial opportunity to conduct a plenary "just and reasonable" review of contract rates and to review the market conditions under which the contract was negotiated – and to conduct such a review not just when the contract is executed, but years later, with the benefit of hindsight. The Ninth Circuit then held that buyers may escape their contractual obligations and obtain rate reductions if, in retrospect, their contract was negotiated in a "dysfunctional" market and established rates that proved to be outside a zone of reasonableness. These standards dramatically undermine sellers' ability to rely on buyers' contractual commitments.

Only this Court can prevent the harm threatened by the Ninth Circuit's errors. For so long as the decisions remain on the books as valid precedents, they create a risk that buyers will be able to escape their contractual commitments – if not these commitments by these buyers, perhaps other commitments by other buyers in the future. Regardless of FERC's eventual decisions about the specific contracts involved here, that risk will remain. Among other things, the Ninth Circuit's new standards will discourage the use of long-term contracts that provide important benefits – facilitating investment, mitigating financial risks, and reducing market volatility. Those standards will also discourage sellers of power from increasing supply when it is most needed, *i.e.*, when prices spike upwards in response to a large imbalance between demand and supply. That is the circumstance in which sellers will least be able to rely on buyers' contractual commitments, because that circumstance is most likely to be characterized, in retrospect, as a market "dysfunction." The standards will vastly increase the likelihood and the cost of litigation, because the enforceability of contracts will no longer depend on the straightforward question whether a contract is valid but will rest, instead, on the amorphous question whether the market was "dysfunctional." In these and other respects, the Ninth Circuit's decisions, unless corrected, will raise the costs and reduce the financial rewards to companies that produce electric power and trade in the wholesale power market. Regardless of the outcome of the specific disputes in these cases, the Ninth Circuit decisions threaten serious harm to the efficient operation of that market and, ultimately, to consumers.

ARGUMENT

I. Unless Corrected, The Ninth Circuit's Interference With The Enforcement Of Contracts Will Undermine An Extraordinarily Important Sector Of The Economy

The electric power industry affects daily life and the Nation's economic well-being to a degree that is matched by few other industries. End users spend about $300 billion annually to purchase electricity in the United States.[2] Electric power is essential to virtually every productive activity in the Nation's economy, and the generation and consumption of electricity is strongly correlated with the overall level of economic activity.[3]

Today, companies that distribute electricity to end users buy the overwhelming proportion of that power in wholesale transactions. This fact reflects fundamental changes in the regulation and structure of the industry over the past decade. For most of the twentieth century, the industry was dominated by vertically integrated utilities that generated electricity, transmitted it to local distribution networks, and provided retail service to end users, subject to cost-based rate regulation. Beginning in the mid-1990s, FERC (regulating wholesale power sales) and many States (regulating retail sales) shifted from cost-based rate regulation to a market-based regime. To ensure competition in wholesale sales, high-voltage transmission lines (which carry electricity from the point of generation to local distribution networks) were subjected to "open access" requirements, permitting many different producers of power to compete to sell power to individual retail distribution companies. In addition, many vertically integrated utilities were divided into separate generation and distribution companies. See generally 06-1457 Pet. App. 11a-22a.

The result of these changes was "a sharp increase in wholesale power sales - subject to FERC's exclusive jurisdiction – as utilities shopped among suppliers." 06-1457 Pet. App. 21a. "[T]he breakup of vertically integrated utilities created the need for many more wholesale transactions." *Ibid.* Three trillion 661 billion kilowatt-hours of electricity were sold at retail in 2005;

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[2] Energy Information Administration, *Revenue from Retail Sales of Electricity To Ultimate Customers by Sector, by Provider* (Oct. 4, 2006), available at http://www.eia.doe.gov/cneaf/electricity/epa/epat7p3.html.

[3] Edison Electric Institute, *U.S. Economic Growth Is Linked To Electricity Growth* (2007), available at http://www.eei.org/industry_issues/industry_overview_and_statistics/realgdp.pdf.

nearly 90% of that amount (3,246 billion kilowatt-hours) was purchased by the companies engaged in retail distribution.[4]

The wholesale market that has developed is broad, diverse, complex, and very, very large. Power is sold in many different ways. Some sales result from bilateral negotiations between individual buyers and sellers; some are effected through a competitive bidding process; some are conducted on organized exchanges. Power is sold in spot markets, in which buyers can acquire power to supply immediate, short-term needs. It is also sold through contracts that provide for the delivery of power over longer time periods, sometimes covering many years.

Participation in the wholesale market has expanded far beyond those companies that produce or distribute electric power. The roster of electric power marketers now includes many large traders, including members of ISDA and FIEG. Some of these firms own interests in power producers and/or distributors; some do not. Regardless, the principal market activity of many of these traders (including those that own interests in producers or distribution businesses and those that do not) consists of contracting with power producers, distribution companies, and other traders to buy or sell wholesale power that will ultimately be produced or distributed by others.

In an important way, the firms that participate in the market principally as traders are unlike power producers selling their own output, or distribution companies purchasing power for resale to end users. Traders tend, over the long term, to be neither net sellers nor net purchasers of power. Traders generally seek to purchase only the power they can sell, and to sell only what they can purchase. Thus, they have no vested interest in rules that systematically favor sellers or buyers. Their interest, instead, is in rules that enhance the efficient operation of the market, for the benefit of both buyers and sellers.

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[4] *Electric Power Annual*, Energy Information Administration (Nov. 9, 2006), available at http://www.eia.doe.gov/cneaf/electricity/epa/epa_sum.html.

These firms play an extremely important role in wholesale power markets. Their expertise and their extensive trading operations allow them to mitigate financial risks. For example, by assembling a diverse portfolio of contractual obligations to buy and sell power at different times and at different prices, these firms can insulate themselves from many of the risks of temporary price volatility as well as longer term unfavorable price trends. Perhaps more important, by contracting with producers and distributors of power, these firms allow the producers and distributors to avoid those risks. A simple, classic example is a retail distributor that chooses to enter into a long-term contract to purchase power at a fixed price. The contract assures the buyer a stable supply of power at a guaranteed price. The risk that prices will rise over the duration of the contract is transferred to the seller, which may be better positioned to mitigate that risk through its extensive trading operations and its expertise in managing financial risk.

A vibrant and efficient market for wholesale power sales provides other important benefits. The market – especially because of the participation of large traders – enhances liquidity in the sale of electric power, so that buyers can readily find sources of supply and sellers can readily find buyers for power. In addition, a well-functioning market enhances the transparency and efficiency of prices, both short term and long term, thereby enabling buyers and sellers to respond more rapidly and efficiently to changing market conditions.[5]

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[5] For recent empirical studies confirming the benefits of broad trader participation in energy markets, see Michael S. Haigh, Jeffrey H. Harris, James A. Overdahl & Michael A. Robe, *Market Growth, Trader Participation and Pricing in Energy Futures Markets* (Feb. 7, 2007), available at http://web.uvic.ca/econ/robe.pdf; Michael S. Haigh, Jana Hranaiova & James A. Overdahl, *Price Dynamics, Price Discovery and Large Futures Trader Interactions in the Energy Complex* (April 28, 2005), available at http://cftc.gov/files/opa/press05/opacftc-managed-money-trader-study.pdf.

To function effectively, the wholesale power market *requires* clear and enforceable contract rights. Such rights are especially important to ensure broad participation in the market by firms other than producers and distributors of power. Producers and distributors, if they wish to remain in business, must sell and buy power. But firms that function principally as traders have choices about the extent to which they will participate in this market. A regulatory environment that impedes their ability to manage risk, by creating uncertainty about contract enforcement, will encourage them to commit their capital to other markets that entail less risk. If that is allowed to happen, the cost to the electric power industry, and to the public (which depends on that industry daily), will be very large. As we explain below, unless reversed, the Ninth Circuit's repudiation of long-settled principles that protected the enforceability of contracts in this market will have that deleterious effect.

II. The Ninth Circuit's Decisions Will Undermine Contractual Expectations That Have Been Protected For More Than Fifty Years By The *Mobile-Sierra* Doctrine

A. The *Mobile-Sierra* Doctrine Has Protected The Integrity Of Contracts For Both Buyers and Sellers, Because Doing So Serves The *Public's* Interests

For more than half a century, long-term contracts for wholesale electric power sales have been negotiated with the understanding that such contracts could be enforced, pursuant to the *Mobile-Sierra* doctrine, even if changes in the marketplace rendered the contract unprofitable for one of the parties.

In *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), this Court held, unanimously, that a natural gas company could not unilaterally modify a contractual rate by filing a new rate with the Federal Power Commission. Notwithstanding requirements in the Natural Gas Act that all rates must be just and reasonable, the Act "expressly recognizes that rates to particular customers may be set by individual contracts" and "evinces no purpose to abrogate private rate contracts." *Id.* at 338. That conclusion was compelled by the terms of the Act and promoted the Act's purposes, as well. "[P]reserving the integrity of contracts * * * permits the stability of supply arrangements which all agree is essential." *Id.* at 344. Parties could not be expected to make "substantial investments * * * without long-term commitments," and such commitments are impossible if "supply contracts are subject to unilateral change." *Ibid.*

The Court followed and extended the *Mobile* decision in another unanimous decision on the same day. *Federal Power Comm'n* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), arose under the Federal Power Act, the relevant provisions of which were "substantially identical" to the provisions of the Natural Gas Act that were construed in *Mobile*. *Id.* at 353. *Sierra* followed *Mobile* in holding that a party could not unilaterally modify the rate established in a long-term contract by filing new rates with the Commission. *Sierra* also addressed a question not presented in *Mobile*: In what circumstances could the Commission determine that contract rates were unlawful, and prescribe modifications to those rates to remedy the perceived unlawfulness? *Sierra* held that the contractual rate could be set aside only if it would "adversely affect the public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." *Id.* at 355. This "public interest" standard is not satisfied merely because the rate prescribed by the contract was a rate that the Commission, itself, could not have imposed under a "just and reasonable" standard. "[W]hile it may be that the Commission may not normally impose upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain." *Ibid.* "[A] contract may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility." *Ibid.* In 2002, the Court explained, again, one of the reasons for that conclusion. "In wholesale markets, the party charging the rate and the party charged were often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon Communications, Inc.* v. *FCC*, 535 U.S. 467, 479 (2002).

Mobile and *Sierra* involved efforts by sellers to increase rates charged to buyers, but subsequent decisions have confirmed that the decisive principle is that contracts must be enforced, not that the financial interests of buyers take precedence over the financial interests of sellers. *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division*, 358 U.S. 103 (1958), held that a seller could unilaterally raise contractual rates by filing the new rates with the Commission, when the contract permitted the seller to do so. "The important and indeed decisive difference between this case and *Mobile* is that in *Mobile* one party to a contract was asserting * * * the right unilaterally to abrogate its contractual undertaking, whereas here petitioner seeks simply to assert * * * rights expressly reserved to it by contract." *Id.* at 112. *Mobile*, *Sierra*, and *Memphis* gave buyers and sellers an option. They could contract for rates that could be set aside only in extraordinary circumstances or, if they preferred, they could contract for rates that could be modified unilaterally (as in *Memphis*), subject to Commission review under the traditional "just and reasonable" standard.

Memphis explained that the integrity of such contracts must be protected, not just to benefit the businesses that entered into those contracts, but to benefit the consuming public. The Court explained that enforcing contractual rights would protect "the legitimate interests of natural gas companies in whose financial stability *the gas-consuming public has a vital stake.*" 358 U.S. at 113 (emphasis added). Without legal protection of producers' contract rights, "the maintenance and expansion of their systems through equity and debt financing would become most difficult, if not impossible." *Ibid.*

In conflict with the Ninth Circuit, other courts of appeals have recognized that the *Mobile-Sierra* doctrine applies evenhandedly to hold buyers to their commitments, even if they have agreed to rates that turned out to be "too high," just as it holds sellers to their commitments when they have agreed to rates that turned out to be "too low." *Boston Edison Co.* v. *FERC*, 233 F.3d 60 (1st Cir. 2000); *Potomac Elec. Power Co.* v. *FERC*, 210 F.3d 403 (D.C. Cir. 2000).

As Judge Boudin has observed for a unanimous First Circuit panel, "[t]he *Mobile-Sierra* doctrine has hung over the electric power and natural gas industries since 1956, and the two cases are probably among the dozen best-known public utility decisions by the Supreme Court in this century." *Boston Edison*, 233 F.3d at 66. The integrity of contracts was a bedrock principle of the regulation of these industries, even under the old regulatory regime in which producers' costs provided the basis for determining just and reasonable rates in most cases. As FERC has recognized, under today's regulatory regime, in which just and reasonable rates are determined principally by private contractual arrangements that are subject to market forces, "[p]reservation of contracts has, if anything, become even more critical." 06-1457 Pet. App. 147a-148a.

B. The Ninth Circuit's Decisions Undermine The Integrity Of Contracts By Dramatically Enhancing Buyers' Ability To Escape Contractual Obligations

Unless they are reversed, the Ninth Circuit's decisions in these cases will have the practical effect of overruling *Mobile* and *Sierra*. The court of appeals' standards for deciding *whether* to apply *Mobile-Sierra* principles to the review of contractual rates, and *how* to apply those principles, pose a large-scale threat to sellers' ability to hold buyers to their contractual commitments.

The Ninth Circuit held that *Mobile-Sierra* principles do not protect contract rates unless the Commission has an opportunity to conduct a "plenary, 'just and reasonable'" review of the rates at the outset of the contract. 06-1457 Pet. App. 41a. To permit that initial review, of course, would require filing the contract rate with FERC, a filing that FERC's rules do not otherwise require. But an opportunity to review the rates is not enough, according to the Ninth Circuit. In addition, the scope of FERC's review must permit consideration of the "propriety of the contract's formation," including whether the contract negotiations "occurred in a functional marketplace." *Ibid.* And, even if contract rates are subject to that initial review, there is still no guarantee that the rates will be protected by the *Mobile-Sierra* doctrine if challenged at some later time. The Ninth Circuit explicitly held that *Mobile-Sierra* did not require enforcement of one of the contracts involved here because, when the contract was negotiated and filed with the Commission, "the full scale of * * * market dysfunction was not nearly as fully known as it is today." 06-1454 Pet. App. 11a. It held, furthermore, that buyers could seek unilateral modifications to rates even if their contract waived the right to do so. 06-1457 Pet. App. 42a-46a.

After creating those prerequisites for the application of *Mobile-Sierra* principles, the Ninth Circuit then gutted the content of those principles. It held that sellers' ability to escape contractual obligations continues to be governed by the *Sierra* standard – whether the contract will "adversely affect the public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." 350 U.S. at 355. Buyers, are the other hand, can escape contractual obligations "if a challenged contract imposes any significant cost on ultimate customers because of a wholesale rate too high to be within a zone of reasonableness." 06-1457 Pet. App. 63a. The standard, in other words, is whether the electric bills of consumers would be "higher than they would otherwise have been had the challenged contracts called for rates within the just and reasonable range." *Id.* at 64a.

These newly created standards drastically undermine sellers' ability to rely on buyers' contractual commitments. The standards make it impossible for sellers to control or confidently predict whether a contract will be enforceable, because a contract may be set aside for reasons entirely unrelated to the behavior of the contracting parties. Here, for example, there is no evidence that petitioners engaged in any market manipulation that affected the contracts. See, *e.g.*, 06-1454 Pet. App. 118a. Similarly, there is no evidence of unfairness, bad faith, or duress by petitioners in the contract negotiations. 06-1457 Pet. App. 33a. And there is no evidence that any of these petitioners had, or exercised, market power. For each of the contracts at issue, the buyer obtained multiple competing offers, and entered the contract voluntarily because the terms of the contract seemed advantageous at the time. See, *e.g.*, 06-1454 Pet. App. 111a-119a (describing CDWR contract negotiations).

None of this matters under the Ninth Circuit's standard, which permits contracts to be set aside if the market is subsequently deemed to be "dysfunctional." Here, the "dysfunction" took the form of a dramatic increase in prices in the California spot market, which was attributed to (1) unusually high demand for electricity, combined with a scarcity of generation capacity, (2) buyers' excessive reliance on spot-market purchases, due to a confluence of regulatory policies, and (3) illegal manipulation of spot-market prices by other participants in that market. 06-1457 Pet. App. 23a-25a. These were market conditions, however, that affected both buyers and sellers, and that (aside from the illegal actors) neither buyers nor sellers could control.

As applied by the Ninth Circuit here, the standard of market "dysfunction" makes no sense. In a properly functioning market, prices are *supposed to* rise and fall in response to changes in market conditions, including changes in supply and demand, and changes in prices in adjacent markets (whatever the cause). Such price movements indicate that the market is working as it should, not that it is dysfunctional. That is especially true when there is no indication – as there is no indication here – that the contracting parties behaved improperly or that the market was not workably competitive at all times.

The Ninth Circuit undermined the sanctity of contracts in yet another way by allowing – indeed, seemingly requiring – the use of hindsight to determine whether a contract was negotiated in a "dysfunctional" market, rather than relying on the information that was available when the contract was negotiated. That approach defeats one of the principal functions of contracts. Long-term contracts *always* involve uncertainty about whether market prices will remain at current levels, will increase, or will decline during the term of the contract, and a corresponding risk that the contract price will turn out to be a bad bargain for either the buyer or for the seller, depending on the direction in which market prices move. For both parties, however, the value of certainty over the term of the contract outweighs the concern that it *might* be possible to secure better prices by forgoing certainty and hoping that market prices move in a favorable direction. That certainty will be lost, and the utility of long-term contracts will be greatly diminished, if the contract price can be adjusted later, based on a retrospective determination that the market conditions *perceived by both buyer and seller when they negotiated their contract* were the result of a market dysfunction. Such a judgment inevitably will be biased against the party that secured the benefit of locking in what turn out in hindsight to have been favorable rates. Making matters worse, the Ninth Circuit applies *Mobile-Sierra* asymmetrically. It puts buyers in a "heads I win, tails you lose" situation, in which they can enforce bargains made by sellers even if those bargains were improvident when made or became disadvantageous in hindsight, while sellers cannot enforce the bargains made by buyers, even if they were provident when made, so long as hindsight suggests that a better bargain could have been struck.[6]

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[6] Public Utility District No. 1 of Snohomish County, for example, appears to have bargained aggressively, and struck an extraordinarily good bargain to assure supply during a period of severe energy shortage, by offering Morgan Stanley the inducement of allowing Morgan Stanley to specify the duration of the long-term contract in exchange for agreeing to Snohomish's price and availability demands. See 06-1457 Pet. 4-5. The California Department of Water Resources likewise bragged about its negotiating successes. See 06-1454 Pet. 8-9. *Only* hindsight allows anyone to question the wisdom of entering into these deals, and even in hindsight no one has suggested *any* supplier would have come to respondents' rescue in the way petitioners did had respondents, at that time, demanded in negotiations the terms they now ask regulators to impose.

The Ninth Circuit's new rules dramatically undermine the utility of contracts, at a time when contracts are more important than ever to participants in this industry. Those rules permit buyers to walk away from their commitments even if there has been no market manipulation, unfairness, bad faith, or duress by the seller and no evidence that the seller exercised market power. The buyer need only be able to show, with the benefit of hindsight, that the market was "dysfunctional" when the contract was negotiated, even if the buyer and the seller were equally aware of (or ignorant of) the extent of the dysfunction, and were equally powerless to do anything about it. But this "protection" is available only to buyers, not to sellers.

Regulatory agencies cannot be expected to oppose the assertion that they should have more discretion, rather than less, to judge on a case-by-case basis whether the operation of market forces will adequately protect the public interest, especially if more discretion permits the agency to offer visible, short-term benefits to a discrete group of consumers. The Ninth Circuit evidently concluded that FERC should have more discretion, in order to help the retail customers of these particular buyers. To do so, it had to create new rules that permit FERC to impose rates that it determines to be within a zone of reasonableness, even when sophisticated parties have voluntarily contracted for different rates and waived their rights to seek rate modifications from FERC. The *Mobile-Sierra* doctrine properly recognizes that a casual disregard for the integrity of contracts will, itself, produce market dysfunction. And *that* market dysfunction, which will broadly affect all consumers for an indefinite time, will cause much more harm to consumers, as we explain below. The Ninth Circuit lost sight of this fundamental point.

III. The Ninth Circuit's New Standards Will Harm Consumers By Impeding The Efficient Operation Of The Wholesale Power Market

The market dysfunction that will arise from the Ninth Circuit's decisions can be prevented only by this Court. If those decisions are not reviewed and corrected, FERC may or may not determine that the rates in these contracts should be reduced. It may read the decisions broadly, to permit or require more aggressive interference with market forces, or narrowly, to uphold the rates in these contracts. But, regardless of how FERC applies the decisions to resolve these particular disputes, the Ninth Circuit's decisions, if uncorrected, will create substantial uncertainty about the extent to which parties can rely on contractual commitments. The risk that contract rates may be modified – if not by FERC as currently constituted, perhaps by FERC when it is controlled by different commissioners; if not these contract rates, perhaps the rates that will be negotiated when prices rise again; if not because of this market "dysfunction," perhaps because of another – is a risk that market participants must reckon with, regardless of FERC's immediate response to the decisions. That risk will remain even if no other court ultimately follows the Ninth Circuit's approach, and even if the Ninth Circuit does not act as drastically in future cases as it has done in these cases. The uncertainty created by having the Ninth Circuit's opinions on the books as valid precedents will *in and of itself* undermine the parties' incentives to enter into mutually and publicly beneficial contracts.

The Ninth Circuit's revisionist interpretation of *Mobile-Sierra* will injure consumers of electric power in several specific ways. *First*, the Ninth Circuit's standards will discourage the use of long-term contracts. Under those standards, the degree of financial risk to sellers will increase in proportion to the duration of the contract. That is because of the risk that, if market prices decline over the duration of the contract, the seller may lose the benefit of the contract price, because the buyer may be able to obtain a reduction in the contract price from FERC under the Ninth Circuit's standards; but, if market prices rise over the duration of the contract, under *Mobile* and *Sierra* themselves the seller will be locked into the unfavorable contract terms for a long period, and will be unable to obtain contract price modifications. Moreover, if a contract locks in a price for a very short period of time, there will be little opportunity for market prices to move dramatically in either direction, and therefore little financial exposure to the seller as a result of the buyer's "heads I win, tails you lose" advantage. There is a much greater likelihood that market prices might move dramatically, and in an unfavorable direction, over the course of, for example, a ten-year contract, than over the course of a ten-day contract.

The large element of risk that the Ninth Circuit has added to long-term contracts will have many undesirable effects. Long-term contracts play an important role in promoting investment in new productive assets. A power producer considering whether to undertake a major capital investment to increase its generating capacity (or a bank that is considering whether to finance that investment) is more likely to do so if it can secure long-term contracts to sell power at a price that would ensure an adequate return on its investment. Indeed, petitioner Sempra invested *more than $1 billion* in new generating capacity in reliance on a long-term contract that the Ninth Circuit has put at risk. Testimony of Michael R. Niggli, Exh. SER-1 at 37-38, FERC Docket No. EL02-60-003 (filed Oct. 24, 2002). Without the ability to rely on buyers' long-term commitments, potential investors in new generation capacity may be reluctant to risk their capital. See *Mobile*, 350 U.S. at 344 (parties cannot be expected to make "substantial investments * * * without long-term commitments" and such commitments are impossible if "supply contracts are subject to unilateral change"); *Memphis*, 358 U.S. at 113 (Without legal protection of producers' contract rights, "the maintenance and expansion of their systems through equity and debt financing would become most difficult, if not impossible."). Long-term contracts similarly play an important role in facilitating investments by buyers, who may rely on long-term price commitments as insurance that their investments will be profitable. See *Mobile*, 350 U.S. at 344 (discussing importance of long-term commitment to buyers' investment decisions). They are also an important tool that is used by market participants to hedge against the risk of unfavorable price movements.

Long-term contracts also tend to mitigate market price volatility and, in some situations, the risk of market manipulation. There is no small irony that buyers' excessive reliance on spot-market purchases was one of the causes of the market dysfunction in this case, and that replacing spot-market purchases with purchases under long-term contracts was an important *solution* to that market dysfunction. 06-1457 Pet. App. 24a-25a. The Ninth Circuit's permissive standard for excusing purchasers from their long-term commitments will undermine sellers' incentives to offer long-term contracts, which will again push buyers towards an excessive reliance on short-term purchases.

Second, the Ninth Circuit's decisions will discourage the production of more electric power when it is most needed to respond to shortages. The elementary laws of supply and demand teach that shortages lead to higher prices, and severe shortages lead to much higher prices. Sensible policy – policy that serves consumers' best interests – would seek to encourage suppliers to sell more electric power when prices spike upwards, in order to alleviate the shortage and reduce prices. The Ninth Circuit's decisions do just the opposite. Under those decisions, the contractual commitments that sellers can *least* rely on are the commitments that buyers make when market prices have spiked upwards. When market prices are exceptionally high, the likelihood that prices will later decline – leading buyers to seek price reductions through the regulatory process – is at its greatest, and a market characterized by unusually high prices is most likely to be described, retrospectively, as "dysfunctional." When consumers would benefit the most from sellers' agreements to provide more power – when market prices have spiked upwards – the Ninth Circuit's decisions create the greatest disincentive for sellers to enter into such agreements.

The Ninth Circuit's standard makes no sense even if market manipulation caused the spike in prices. If market manipulation has created an artificial shortage, the most effective remedy will be to encourage other market participants to alleviate that shortage by increasing the level of market supply.[7] That response will minimize the harm caused by the manipulation and reduce the wrongdoers' illicit gains, thereby reducing the temptation to engage in market manipulation. The surest means of preventing that desirable response will be to deny benefits (by refusing to enforce their contracts) to those who contract to sell more electricity during periods of market turmoil.

Third, the Ninth Circuit's decisions will lead to enormous litigation costs. When the *Mobile-Sierra* doctrine is properly applied, litigation over long-term supply contracts is rare and relatively cheap. The principal issue to be decided is whether the disputed contract is valid. That issue frequently can be decided merely by examining the contract or, in unusual cases, the behavior of those who were involved in negotiating the contract, to determine if they acted deceptively or in bad faith. The Ninth Circuit's decisions will expand both the circumstances in which buyers will be motivated to initiate litigation to escape their contractual commitments, and the scope and likely cost of that litigation. Instead of applying well-settled principles of contract law to determine the validity of the contract, the litigation will now address the amorphous question whether the market was "dysfunctional" when the contract was negotiated – a question that may require examination of a wide array of economic and regulatory conditions and the conduct of other market participants. If that inquiry leads to the conclusion that the market was dysfunctional, the litigation must also determine the effects of the market dysfunction, *i.e.*, the amount by which the contract rate exceeds the "just and reasonable" rate. These enhanced litigation costs will be especially burdensome for firms that are principally traders. In this intensely competitive business, profit margins are modest and will be substantially eroded if those contracts that are most favorable to the seller can be enforced, if at all, only by spending large sums on litigation.

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[7] See Charles Augustine, Joseph Cavicci & Joseph Kalt, *Competition and Regulation, Part III, Tensions Evolve Between Competition and Regulation*, ELECTRIC LIGHT AND POWER (Jan. 2006), available at http://uaelp.pennnet.com/Articles/Article_Display.cfm?Section=ARTCL&ARTICLE_ID=247218&VERSION_NUM=2&p=34 ("[A]s our antitrust principles recognize, if a dominant seller, A, unlawfully exercises market power, its prices can properly be judged to be unjust and/or unreasonable. At the same time, however, these principles recognize that A's exercise of market power will generally pull up the prices of otherwise faultless sellers B, C, D . . . Z, and will induce expansions in those sellers' supplies. In market-driven price regimes, this is desirable: The responses of B, C, D . . . Z dampen the impact of A's conduct and hold overall price levels lower than they would be if these other sellers did not respond. B, C, D . . . Z's prices may be 'high' but B, C, D . . . Z's responses help consumers.").

Fourth, in these respects and others, the Ninth Circuit's decisions will tend to raise the costs and to reduce the financial rewards to companies that produce electric power, and to companies that trade in wholesale power markets. Inevitably the supply of electric power will be reduced and its price driven up.

The decisions will have that effect regardless of the ultimate outcome of the specific disputes involved in these cases. Billions of dollars of contractual commitments are at issue in these cases, but even those billions of dollars are ultimately far less significant than the fact that the Ninth Circuit has severely undermined expectations that contracts will be enforced in all but the most extraordinary circumstances. Sellers in the wholesale power market (and not just the sellers in these particular contracts) will experience the harmful effects of these decisions in the first instance. Far greater harm, however, will arise from the damage that these decisions will inflict on the efficient operation of the market for wholesale electric power, and on the consumers of electric power who are the ultimate beneficiaries of an efficient market.

CONCLUSION

The petitions for a writ of certiorari should be granted.

Respectfully submitted.

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Nos. 06-1454, 06-1457, 06-1462 and 06-1468

IN THE
SUPREME COURT OF THE UNITED STATES

SEMPRA GENERATION, *ET AL.*, PETITIONERS,
v.
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA, *ET AL.*, RESPONDENTS.

MORGAN STANLEY CAPITAL GROUP INC., *ET AL.*,
PETITIONERS,
v.
PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH
COUNTY WASHINGTON, *ET AL.*, RESPONDENTS.

ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF *AMICUS CURIAE* OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA IN SUPPORT OF THE PETITIONS FOR WRIT OF *CERTIORARI*

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I. INTEREST OF AMICUS CURIAE

This brief *amicus curiae* in support of the petitions is submitted pursuant to Rule 37 of the Rules of this Court. Counsel for Petitioners and Respondents have consented to the filing of this brief. Their consent letters have been filed with the Clerk of the Court.

The Interstate Natural Gas Association of America ("INGAA") is a trade organization that advocates regulatory and legislative positions of importance to the natural gas pipeline industry in North America.[1] INGAA represents virtually all of the interstate natural gas transportation pipeline and interstate natural gas storage companies operating in the U.S., as well as comparable companies in Canada and Mexico. Its members transport over 95 percent of the nation's natural gas through a network of 180,000 miles of pipelines. INGAA and its individual members have a substantial interest in contract stability, continued investment in energy infrastructure, and in ensuring predictable, rational and fair law and policy affecting natural gas transportation.

INGAA supports the petitions for a writ of *certiorari*. *Public Utility District No. 1 of Snohomish County Washington v. FERC,* 471 F.3d 1053 (9th Cir. 2006) ("*Snohomish*") and *Public Utilities Commission of the State of California v. FERC,* 474 F.3d 587 (9th Cir. 2006) ("*Cal PUC*") are two Ninth Circuit companion decisions addressing the Federal Energy Regulatory Commission's ("FERC") market-based rate regime for power marketers. These decisions have implications for FERC's market-based rate policy for interstate natural gas pipeline transportation and storage providers. These decisions may also affect other pipeline rate methodologies.

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[1] No counsel for any party authored this brief in whole or in part, and no person or entity other than INGAA made a monetary contribution to the preparation or submission of this brief.

The Natural Gas Act, 15 U.S.C. § 717 *et seq.* (2000) ("NGA"), as interpreted by this Court, does not mandate any particular type of ratemaking for interstate transporters. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). Rates charged by INGAA members present a broad spectrum of all the rate-setting methodologies permitted under FERC's regulations. INGAA-member rate methodologies include traditional cost-of-service rates, market-based rates (usually premised on an absence of market power), and a number of variations based on individual negotiations, discounts, and rates achieved through settlement. Most interstate natural gas transporters (which term includes pipelines and storage) charge rates that are cost-based or are based upon cost-based rates,[2] and that are directly filed with and subject to review by FERC.

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[2] Interstate natural gas transporters traditionally charge rates based upon the cost of constructing and maintaining the transportation facility plus a FERC-regulated rate of return. FERC has also long permitted interstate natural gas transporters the opportunity to offer "discounted rates." *Assoc. Gas Distribs. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987) ("*AGD*"). Discounted rates are the transporter's cost-based rates minus any non-discriminatory discount needed to meet competition. Interstate transporters are also allowed to enter into "negotiated rate" agreements with their customers, as long as the transporter also offers cost-based maximum "recourse rates," which the customer can choose as an alternative if negotiations are not successful. Thus, negotiated rates can only be charged when the shipper has a cost-based alternative

The interstate natural gas pipeline industry is one of the United States' most capital-intensive industries, and one of the few industries that remains subject to public utility-type economic regulation. To underwrite needed investment, it is critically important to project sponsors that long-term contracts can be relied upon to assure eventual cost recovery over the life of the project. Such reliance might be misplaced where buyers are favored over sellers in contract disputes, and where contracts and market-based rate authority are subject to *post hoc* second-guessing.

There are factual and legal differences between market-based rates charged by power marketers and market-based rates charged by interstate pipelines and storage providers. The authority for, and use of, such pricing mechanisms are very different between industries.[3] These factors arguably render *Snohomish*

Ftn. cont'd.

and the shipper has chosen negotiated rates. In contrast, market-based rates are set entirely by the market. The cost basis of the service is not assessed, no recourse rate is stated in the tariff, and the shipper is not offered a cost-based alternative. *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines*, 74 FERC ¶ 61,076 (1996).

[3] Sellers of natural gas transportation and storage services, as well as sellers of electric power, who want market-based rate authority must make individualized showings that they lack market power with respect to specific facilities and relevant product and geographic markets. However, electric power sales at market-based rates are made by numerous sellers that may or may not own or control physical generating or transmission facilities. In contrast, natural gas transporters sell transportation service rather than a commodity and always own or lease physical facilities, which tend to limit their

and *Cal PUC* inapplicable to contracts between FERC-regulated interstate transporters and their customers. There are even more significant differences between market-based rates and the other rate methodologies—such as traditional cost-of-service, negotiated and discount rates—employed with respect to interstate pipelines.

Despite the distinctive factual and regulatory characteristics of natural gas transportation services, the uncertainties and risks created by the *Snohomish* and *Cal PUC* decisions are of concern to natural gas transporters. The holding in *Snohomish* and *Cal PUC* is broadly stated and confusing. The uncertainty created by the asymmetric treatment and the *post hoc* revisions of contracts could, therefore, have adverse effects on market-based rates in other contexts.

Ftn. cont'd.

relevant markets and may make the requisite showing that they lack market power more rigorous at the outset. Consequently, almost all natural gas transporters holding market-based rate authority are relatively new natural gas storage providers. Also distinguishing natural gas transporters from market-based rate sellers of natural gas or electric power is the clear Congressional intent to increase the usage of market-based rates for interstate natural gas storage providers. Section 312 of the Energy Policy Act of 2005 ("EPAct 2005"), Pub. L. No. 109-58, § 312, 119 Stat. 594, 688 (2005) which adds a new section 4(f) to the NGA, permits FERC to approve certain natural gas storage projects at market-based rates even without a "no-market-power" showing, and reflects a Congressional mandate that sellers of electric power and natural gas do not possess.

II. STATEMENT OF THE CASE

The facts below, and the implications of the Ninth Circuit's decisions for sellers of electric power at market-based rates, have been thoroughly discussed in the petitions for *certiorari* and will not be repeated here. This *amicus* brief supplements the Petitioner briefs with an additional perspective drawn from the interstate natural gas pipeline and storage industry. INGAA's focus is on two specific errors: (1) the Ninth Circuit's asymmetric treatment of buyers and sellers under its interpretation of the *Mobile-Sierra* Doctrine and (2) the Ninth Circuit's *post hoc* reevaluation of contracts entered into pursuant to final and effective market-based rate authorizations, based upon an after-the-fact review of facts in existence at the time the contracts were executed.

III. SUMMARY OF THE ARGUMENT

In the *Snohomish* and *Cal PUC* decisions, the Ninth Circuit addressed complaints that sought to modify, after-the-fact, long-term contracts executed in prior years. FERC had carefully considered the facts surrounding contract formation and had rejected those complaints, holding that the complaints were precluded under the public interest standard established pursuant to *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (the "*Mobile-Sierra* Doctrine"). In remanding these FERC orders, the Ninth Circuit decisions fundamentally alter the *Mobile-Sierra* analysis by creating an unequal or asymmetric test for setting aside contracts under *Mobile-Sierra*. The Ninth Circuit's decisions create an asymmetric test under *Mobile-Sierra* that favors the interests of the buyer over those of the seller. Such asymmetric treatment of the contracting parties undermines the integrity of long-term contracts, is economically unsound, contrary to basic contract law, and contrary to the decisions of this Court.

The Ninth Circuit's decisions also erred by allowing improper *post hoc* challenges to existing contracts entered into pursuant to FERC-approved and effective market-based rate authorizations. Even if FERC had initially erred in allowing sellers to utilize market-based rate authority, FERC's market oversight authority must be exercised prospectively. This oversight authority cannot be used to invalidate contracts that were executed prior to the filing of a complaint, and that were entered into pursuant to FERC-approved market-based rate authorization that was effective at the time the contracts were executed. It is analogous to prohibited retroactive ratemaking for the Ninth Circuit 'to order FERC to entertain such after-the-fact challenges.

The Ninth Circuit's asymmetric treatment of buyer and seller and its improper *post hoc* invalidation of contracts entered into pursuant to FERC-approved market-based rate authority will interject new regulatory risk into the energy industry. This precedent could chill investment and drive up the risk premiums demanded by investors for energy infrastructure projects that are supported by contracts. The Ninth Circuit's decisions raise concerns that years down the line, contracts may be second-guessed under the *Snohomish* and *Cal PUC* precedents. These effects of the Ninth Circuit precedents could drive up costs to consumers and drive down reliability.

IV. ARGUMENT

A. ASYMMETRIC TREATMENT OF BUYERS AND SELLERS IS ECONOMICALLY UNSOUND AND CONTRARY TO THE DECISIONS OF THIS COURT.

1. The Ninth Circuit's rulings require asymmetric application of the *Mobile-Sierra* Doctrine.

The Ninth Circuit's decisions create a new, asymmetric test for setting aside contracts under the *Mobile-Sierra* Doctrine. The decisions modified the *Mobile-Sierra* Doctrine by holding that a remorseful ***buyer*** complaining of rates that are too high can more readily void a valid contract than a remorseful ***seller*** complaining of rates that are too low. The Ninth Circuit held that FERC had committed reversible error by applying the factors articulated in *Sierra*, which involved a seller's complaint about low contract rates (a "low-rate challenge"), to a buyer's complaint about high contract rates (a "high-rate challenge"), *Snohomish*, 471 F.3d at 1087 (citation omitted). The Ninth Circuit said that, in its view, "the key 'public interest' in a high-rate challenge . . . is assuring that the consuming public pays fair rates. . . ." *Id.* at 1089. The Ninth Circuit instructed FERC to accept a **buyer's** challenge to a contract under the public interest test if the contract rates are higher than "a zone of reasonableness" and retail rates would have been lower "had the wholesale contract rates been lower." *Id.* In contrast, in the Ninth Circuit's view, a **seller** must continue to meet a heavy burden before a rate may be changed. "When a customer has negotiated a low contract rate, FERC must meet a high burden before raising that rate." *Id.* at 1088.

Snohomish and *Cal PUC* thus set the stage for the disruption of contracts—by buyers—where buyers later wish to undo their contractual obligations. Undermining the stability of long-term contracts in a way that consistently favors one side over the other, creates new risk and discourages investment. Long-term contracts allow parties to share the many risks of a major investment in energy infrastructure. For example, the commercial viability of facilities over their economic lifespan is affected by shifting supply and consumption patterns, as well as competition from other pipelines, storage facilities and other energy sources entering the market. Through sharing major investment risks, long-term agreements underwrite and promote infrastructure construction. Major investment in U.S. energy infrastructure will be needed in the future to meet growing needs.[4] Long-term contracts are important, not just in the context of market-based rates, but with respect to other rate making methodologies, such as traditional cost-of-service rates and increasingly important "negotiated rates."[5]

The *Mobile-Sierra* Doctrine has never before been applied asymmetrically. The Doctrine originated long before market-based rates, and the protections it has afforded contracting parties have been relied upon in many other rate-making contexts, including traditional cost-of-service rates (*Wis. Gas Co. v. FERC*, 770 F.2d 144, 166-67 (D.C. Cir. 1985); *Exxon Corp. v. FERC*, 206 F.3d 47 (D.C. Cir. 2000); *Texaco Inc. v. FERC*, 148 F. 3d 1091 (D.C. Cir. 1998)) and discounted rates (*AGD*, 824 F.2d at 1009). The Ninth Circuit's asymmetric "high case-low case" standard for relief under *Mobile-Sierra* could undermine needed investment and is contrary to fundamental principles of contract law, is economically unsound, and is contrary to the decisions of this Court.

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[4] *Strategic Plan For Fiscal Years 2006-2011*, Federal Energy Regulatory Commission 7 (Sept. 2006), *available at* http://www.ferc.gov/about/strat-docs/strat-plan.asp. *See also An Updated Assessment of Pipeline and Storage Infrastructure for the North American Natural Gas Market: Adverse Consequences of Delays in the Construction of Natural Gas Infrastructure*, INGAA Foundation, Inc. 7-8 (2004), *available at* http://www.ingaa.org/cms/31/43/678/45.aspx (estimating that the natural gas transportation industry must invest $61 billion in constant 2003 dollars by 2020 in the U.S. and Canada).

[5] *See* footnote 2, *supra*, for a description of "negotiated rates."

2. The asymmetric treatment of buyers and sellers is economically inefficient, and is contrary to fundamental principles of contract law.

A regulatory regime in which long-term contracts can potentially be voided by the buyer increases the risk of "hold up"—one side taking advantage of the other's inability to undo an investment. *See, e.g.*, O.E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 42-51 (1985). The threat of customer "hold-up" could increase financing costs or prevent project financing altogether. The increased risk associated with the possibility that at some point in the duration of a long-term contract the contract might be undone will tend to raise the required return on investment and will tend to reduce investment.

To make matters worse, customers freed of their long-term contractual obligations to pay for service under the principles adopted in *Snohomish* and *Cal PUC* could often continue to use the same utility facilities on what amounts to a firm basis if the facility owner is unable to line up alternate, long-term users of the facility. Firm contracts underwrite the construction and operation of a pipeline by way of a reservation charge, paid whether or not service is taken, which reservation charge helps to compensate the service provider for the often seasonal nature of its business. JAMES C. BONBRIGHT, *ET AL.*, PRINCIPLES OF PUBLIC UTILITY REGULATION 399-401 (2nd. Ed. 1988). Customers able to void their contractual obligations could take interruptible service without payment of a reservation charge, and under such circumstances the pipeline's full cost would likely not be recovered.

Long-term, enforceable contracts between a creditworthy shipper and pipeline can alleviate risks that the shipper will engage in opportunistic behavior. Such contracts can thereby encourage needed construction. However, utility service providers may be fearful of a future FERC ruling that the market conditions at the time of contract formation were, in hindsight, "dysfunctional" from the perspective of the buyer. Under such circumstances, utility service providers might not invest in infrastructure or might require an added risk premium to compensate for the heightened risk posed by the *Snohomish* and *Cal PUC* precedents. This could be a disincentive to provide new or expanded service where and when market demand indicates that service is most highly valued. In a regime in which regulatory intervention takes place for the benefit of buyers under bilateral contracts, "a natural inference is that suppliers who could otherwise profitably enter will be deterred from entry." *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964, 969 (D.C. Cir. 2005). Such after-the-fact intrusion into contracts, especially in a manner designed consistently to benefit the buyer, could "wreak substantial harm—in curtailing price increments attributable to genuine scarcity that could be cured only by attracting new sources of supply." *Id.*

Under the economically inefficient asymmetric regime established under the Ninth Circuit's rulings, future consumers could be harmed both with regard to prices paid and with regard to reliability of supply. It would be in precisely those situations when scarcity had driven prices their highest and when new supply was most needed by a buyer that a seller would be placed at highest risk that a contract signed under such circumstances would be second-guessed at a later time. In times of scarcity, under the asymmetric application of the *Mobile-Sierra* Doctrine articulated by the Ninth Circuit, the buyer may be left with sellers willing to sell only on an extremely short-term basis or may be left with no seller willing to step forward at all. *See generally* David G. Tewksbury & Stephanie S. Lim, *Applying the Mobile-Sierra Doctrine to Market-Based Rate Contracts,* 26 Energy L. J. 437, 469-72 (2005).

The asymmetric treatment of buyers and sellers under a contract also violates fundamental principles of contract law. Changes in cost alone do not excuse contract performance. *See, e.g.*, Uniform Commercial Code, Section 2-615(a) Comment 4. A party's obligation to perform under a contract, based on the emergence of risks that were not foreseen at the time the contract was entered, might conceivably be excused under some factual scenarios, such as impracticability of performance or frustration of purpose. However, the facts of the cases below do not warrant such relief. As shown by the Petitioners, the FERC found that the subject contracts were voluntarily negotiated by sophisticated parties, that entry into the contracts were reasonable at the time, that there was no price manipulation by the sellers, and that there was no contractual basis for voiding the contacts. It is the very essence of a contract that it is directed at the elimination of some risks for each party in exchange for accepting others. Each party receives the certainty of price, quantity, and time, and assumes the risk of changing market prices, superior opportunity, or added costs.

Protecting a buyer by voiding a contract that the buyer later determines was improvident may offer short-term relief to that particular buyer, but such protection is costly to society in the long run. A central benefit of a contract is the assurance it provides that parties will receive a return for investments that have specific value in their relationship. Without such assurance, a party has a diminished incentive to invest, because that party may ultimately be deprived of its bargain. "Courts that void contracts to provide insurance do so at the cost of reducing the ability to provide incentives for an efficient level of *ex-ante* investment." L. Anderlini, *et al., Courts of Law and Unforeseen Contingencies*, J. Law, Econ. & Org. 2 (Sept. 13, 2006), *available at* http://jleo.oxfordjournals.org/cgi/content/abstract/ewm017v1.

In sum, the Ninth Circuit's asymmetric standard for relief under *Mobile-Sierra* could undermine investment, particularly where investment is most needed, is contrary to fundamental principles of contract law and to the decisions of this Court.

B. THE NINTH CIRCUIT DECISIONS IMPROPERLY REQUIRE FERC TO CONSIDER *POST HOC* CHALLENGES TO CONTRACTS ENTERED INTO PURSUANT TO EFFECTIVE MARKET-BASED RATE AUTHORITY.

The Ninth Circuit's rulings improperly allow after-the-fact challenges to contracts entered into pursuant to an effective FERC-approved market-based rate authorization. In so doing, the Court failed to observe the requirement, analogous to the rule against retroactive ratemaking, that remedies be implemented on a prospective basis. *Snohomish* and *Cal PUC* appear to require FERC to consider retroactive correction of "errors" discovered, in hindsight, by the Court on review. Under the Ninth Circuit's ruling, such a correction can be based upon evidence in existence at the time the contracts are executed and prior to the time a complaint is filed. This is a new and unprecedented holding that, unless corrected, will cause uncertainty that may chill investment and injure not only regulated companies but consumers that rely upon those companies for service.

The Ninth Circuit ruled that "*Mobile-Sierra* cannot apply without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." *Snohomish*, 471 F.3d at 1086. The Ninth Circuit improperly looks back to evidence in existence as of the dates upon which the Petitioners' market-based rate authority was granted and the dates upon which the contracts here at issue were entered, and implies that FERC should set aside those contacts based upon that evidence. *Id.* at 1086-87. In the Ninth Circuit's view, market dysfunction or other problems allegedly affecting the initial formation of the contract can be revealed in hindsight and in the fullness of time—after the buyer may have derived all benefit from the agreement. This after-the-fact contract abrogation may leave the seller with ancillary contracts and investments that the seller cannot similarly void. The Ninth Circuit's decisions appear to require FERC to entertain *post hoc* contractual challenges and to consider retroactive remedies, based upon market facts already in existence at the time of contract formation. Combined with the asymmetric favoritism toward buyers, this precedent is potentially damaging to service providers and consumers alike.

Generally, remedies are prospective in nature. Changes, if any, to the Petitioners' market-based rate authority may occur only from the dates of a complaint and changes to contracts must be dealt with prospectively as well.[6] If the Court had concerns with the market-based rate authorization, the proper remedy would have been forward-looking changes to the seller's authorizations or to the market oversight process. Such changes would apply on a prospective basis to future market-based rate agreements, but previously executed agreements should not have been invalidated.

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[6] A successful rate challenge under NGA Section 5, 15 U.S.C. § 717d, will result in new rates effective on and after the date the rate ruling becomes final and non-appealable, and no refunds are contemplated. The refund effective date provision under FPA Section 206 was recently amended by Section 1285 of EPAct 2005 to require that, in the case of a proceeding instituted on a complaint, the refund effective date shall not be earlier than the date of the filing of such complaint or later than five months after the filing of such complaint. EPAct 2005, Pub. L. No. 109-58, § 1285, 119 Stat. 594, 980-81 (2005).

As they stand, the Ninth Circuit's decisions appear to authorize remedies based on evidence that dates back to the time of contract formation and market-based rate authorization. The Ninth Circuit's rulings are, in this respect, analogous to retroactive ratemaking, which is proscribed by statute, precedent and long tradition. Section 5 of the NGA and Section 206 of the Federal Power Act ("FPA"), 16 U.S.C. § 824e, both require prospective rate changes when the rate change is not initiated by the utility.[7] The "Commission itself has no power to alter a rate retroactively." *Ark. La. Gas Co. v. Hall,* 453 U.S. 571, 578 (1981). This rule bars "the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate." *City of Piqua v. FERC*, 610 F.2d, 950, 954 (D.C. Cir. 1979). By authorizing only prospective rate changes, the rule against retroactive ratemaking ensures rate predictability. *See Con. Edison Co. of N.Y., Inc. v. FERC,* 347 F.3d 964 (D.C. Cir. 2003); *Columbia Gas Transmission Corp. v. FERC,* 895 F.2d 791, 793 (D.C. Cir. 1990). By preventing discriminatory pricing, these rules promote equity. *See Exxon Co., U.S.A. v. FERC,* 182 F.3d 30, 49 (D.C. Cir. 1999). The Ninth Circuit has failed to consider how its decisions have undermined these policy considerations.

Under the guise of advocating "oversight" of market-based rates, the Ninth Circuit ruling has engaged in a harmful after-the-fact review of valid contracts and lawful grants of market-based rate authority. The Ninth Circuit has called upon FERC to second-guess and possibly to undo contracts and market-based rate authority. The Ninth Circuit has instructed that such second-guessing may be based upon market facts already in existence at the time contracts were formed, and has also ruled that FERC must favor the buyer in any such reevaluation. As with the Court's asymmetric application of the *Mobile-Sierra* Doctrine, an unclear precedent which encourages after-the-fact changes to the bargains struck by the buyers and sellers will interject new risk into long-term contracts. Those risks will be particularly great for parties that rely upon their contracts to underwrite major capital investments.

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[7] The FPA establishes a regulatory scheme for electricity paralleling that which the NGA creates for gas. *Sierra,* 350 U.S. at 353.

The Ninth Circuit tries to paint a benign face on its holding, saying that it was merely attempting to assure that FERC was adequately overseeing the market and that the sellers' market-based rate authority was not based upon stale data. *See, e.g., Snohomish*, 471 F.3d at 1085. FERC does, of course, have an oversight obligation with respect to all types of rates. The Ninth Circuit has not explained, however, how this obligation would support after-the-fact challenges to contracts validly entered into pursuant to effective, FERC-approved market-based rate authorizations. Even assuming the existence of alleged defects in the market, these problems can only be addressed prospectively.

The Ninth Circuit has acted arbitrarily and capriciously by allowing *post hoc* challenges to valid contracts and final market-based rate authorizations, and by inviting retroactive remedies to resolve these challenges. Along with the asymmetric application of the *Mobile-Sierra* Doctrine, the Ninth Circuit's rulings are contrary to the rulings of other federal circuits, to rulings of this Court, to statute and to rational policy. Granting the writ of *certiorari* requested by the Petitioners would be appropriate in order to correct these errors.

C. THE *CORAL* CASE IS DISTINGUISHABLE AND DOES NOT SUPPORT DENIAL OF *CERTIORARI.*

This Court has recently denied *certiorari* in a facially similar case, *Coral Power, L.L.C. v. California*, 383 F.3d 1006 (9th Cir. 2004), *cert. denied*, 127 S.Ct. 2972 (U.S. 2007) ("*Coral*"). Like the decisions at bar, *Coral* was a Ninth Circuit case that called into question the regulatory certainty of market-based rate electric power transactions. The vital difference, however, is that *Coral*, which grants FERC's retroactive remedial authority with respect to sellers that did not properly report market-based rate transactions, did not revise the *Mobile-Sierra* Doctrine established by this Court and set a new and unclear standard under which buyers would be favored over sellers in contract disputes. Moreover, the decisions now before this Court subject sellers to this new asymmetric standard even if they complied with all of FERC's requirements for obtaining and maintaining market-based rate authority. The cases at bar thus present important legal and policy issues not present in *Coral*. For this reason this Court's recent denial of *certiorari* in that case does not support denying *certiorari* in the cases at bar.

V. CONCLUSION

For the foregoing reasons, this Court should grant the writs of *certiorari* as requested by Petitioners.

Respectfully submitted,

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NOS. 06-1454, 06-1457, 06-1462, 06-1468

In the

Supreme Court of the United States

SEMPRA GENERATION *et al.*, PETITIONERS,
v.
PUBLIC UTILITIES COMMISSION OF THE STATE OF CA, *et al.*

MORGAN STANLEY CAPITAL GROUP, INC., PETITIONER,
v.
PUBLIC UTILITY DIST. NO. 1 OF SNOHOMISH COUNTY WA, *et al.*

CALPINE ENERGY SERVICES, L.P., *et al.*, PETITIONERS,
v.
PUBLIC UTILITY DIST. NO. 1 OF SNOHOMISH COUNTY WA, *et al.*

DYNEGY POWER MARKETING, INC., *et al.*, PETITIONERS,
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On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

BRIEF OF THE NATURAL GAS SUPPLY ASSOCIATION AND INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AS *AMICI CURIE* IN SUPPORT OF THE PETITIONS FOR CERTIORARI

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QUESTIONS PRESENTED

Under the Natural Gas Act and the Federal Power Act, as interpreted by this Court in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and in *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), the Federal Energy Regulatory Commission may not modify valid contracts except in extraordinary circumstances of unequivocal public necessity. In conflict with this Court's decisions and those of other Courts of Appeals, the Ninth Circuit held that the Commission may nullify a wholesale power contract, even in the absence of public necessity, if the contract rates were not pre-approved by the Commission or if the contract is later deemed to have been formed during a period of market "dysfunction."

The questions presented are:

1. Whether the Ninth Circuit erred in failing to abide by this Court's decisions precluding the Federal Energy Regulatory Commission from retroactively abrogating valid, wholesale power contracts absent a showing that abrogation is required in the public interest.

2. Whether the Ninth Circuit erred in effectively determining that the *Mobile-Sierra* public-interest standard applies to sellers, but not buyers, that are seeking to escape the terms of freely negotiated wholesale power contracts.

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INTEREST OF *AMICI CURIAE*[1]

The Natural Gas Supply Association ("NGSA") represents U.S.-based producers and marketers of natural gas on issues that broadly affect the natural gas industry. The Independent Petroleum Association of America ("IPAA") represents independent oil and natural gas producers and associated service companies. As the voice of the producers and marketers who find, produce, sell, and deliver most of the Nation's natural gas supply, NGSA and IPAA work to ensure reliable and efficient delivery of natural gas to end-consumers and to increase the supply of natural gas to domestic markets. NGSA's and IPAA's members have made significant financial commitments in reliance on the current structure of the Nation's energy markets. These commitments are necessary to satisfy the demand for natural gas for all end-uses—including electric power produced by natural gas generation facilities, which represents the single fastest growing component of natural gas demand in the United States.

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[1] Petitioners and respondents have consented to the filing of this brief in letters on file in the Clerk's office. Pursuant to S. Ct. R. 37.6, *amici* state that no counsel for a party authored any part of this brief. No person or entity other than *amici*, their members, or their counsel made a monetary contribution to the preparation or submission of this brief. The attorneys preparing this brief direct the Court's attention to the fact that a second brief as *amici curiae* will be filed in these same cases on behalf of the Electric Power Supply Association and others by different attorneys from the same law firm. Although the attorneys working on the two briefs have shared work product and engaged in joint efforts, the resulting briefs are independent statements reflecting the independent views of the respective clients on whose behalf the two individual briefs are being filed.

The decisions of the Ninth Circuit below place in doubt the willingness of that Circuit and the ability of the Federal Energy Regulatory Commission faithfully to apply this Court's landmark, half-century-old, decisions in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.,* 350 U.S. 332 (1956) and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), at least as those decisions apply to market-based rate contracts for electricity. The Ninth Circuit decisions have therefore cast a pall of uncertainty over future investments in electric generating infrastructure, including infrastructure designed to run on natural gas. More broadly, the decisions raise troubling questions as to how far any tremors from the precedential aftershocks of the Ninth Circuit's doctrinal departures will radiate out from electricity markets and into natural gas markets within the Commission's jurisdiction. Depending on their magnitude, those precedential aftershocks risk unsettling crucial parts of what had been thought to be settled rules and practices governing natural gas transactions. It is for these reasons that NGSA and IPAA are taking the unusual step of making their views known to the Court, even though the underlying decisions, properly interpreted, do not apply to the natural gas industry.

INTRODUCTION

Over a half-century ago, this Court first articulated what has come to be known as the *Mobile-Sierra* doctrine. The Court described that doctrine as embodying Congress's "reasonable accommodation between the conflicting interests of contract stability on the one hand and public regulation on the other." *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 344 (1956); *see also Federal Power Commission v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956). Since then, the courts and (with some infrequent exceptions) the Commission have consistently and wisely declined invitations to modify the terms of fixed-price bulk energy contracts except in "*extraordinary* circumstances" where revised contract terms are clearly "*necessary* in the public interest." *Mobile*, 350 U.S. at 344 (emphasis added).

Regulatory certainty, including the assurance that contracts for Commission-jurisdictional services are protected by *Mobile-Sierra*, has played a central role in the Nation developing and maintaining "the largest and most liquid gas market in the world." National Petroleum Council, Balancing Natural Gas Policy: Fueling the Demands of a Growing Economy, at 48 (2003). Together with pro-competitive initiatives adopted by Congress and the Commission, regulatory certainty has produced robust natural gas markets that enable the natural gas industry to respond effectively to price signals. Most importantly, markets conveying clear price signals have prompted billions of dollars of investment in North American gas infrastructure, representing an "important market success story" that sharply contrasts to the endemic underinvestment experienced under past regulatory regimes. FERC, 2004 State of the Markets Report, at 7, 145 (June 2005); *see also* EIA, The Majors' Shift to Natural Gas, at 19 (2001). Regulatory certainty has thus enhanced the stability of natural gas supplies, which is essential to keeping gas prices at reasonable levels in a growing economy. *See* Asia Pacific Energy Research Centre, Natural Gas Market Reform in the APEC Region, at 149 (2003) ("APEC Region"). The happy result has been an "exciting new industry characterized by free market enterprise, competition and continual innovation." Bob Shively & John Ferrare, Understanding Today's Natural Gas Business, at 1 (2004).

The Ninth Circuit's doctrinal departures threaten to undermine these successes. If allowed to stand, the decisions risk exposing American consumers to the same types of high and volatile prices and frequent supply shortages that prompted Congress and the Commission to discard the regulatory practices of the past in favor of supply arrangements that are at once more flexible, more stable, and more reliable.

REASONS FOR GRANTING THE WRIT

This Court should grant *certiorari* to correct the Ninth Circuit's unwarranted and unwise judicial policymaking in an industry of central national importance. As petitioners explain, by setting aside congressional policy, the Ninth Circuit decisions have opened a conflict with the longstanding precedent of both this Court and other Courts of Appeals. Because fuel costs are the largest variable cost involved in producing electricity, the lower court's destabilization of the already volatile electricity market could have significant spillover effects in the Nation's natural gas markets. (*See* Section I, below.) Moreover, by calling into question the Ninth Circuit's respect for *Mobile-Sierra*'s well-understood principles, the decisions below may infect the natural gas markets with legal uncertainty—in the form of fears that the Ninth Circuit's unwise decisions might be improperly extended to encompass certain natural gas transactions. (*See* Section II, below.) Both types of disruption threaten the interests of the very consumers the Ninth Circuit decisions were intended to protect.

I. Because The Nation's Electricity And Natural Gas Markets Are Increasingly Interdependent, The Ninth Circuit Decisions Could Spill Over Into Natural Gas Markets.

The Ninth Circuit decisions dramatically depart from this Court's precedents by inventing a new test for determining whether *Mobile-Sierra*'s public-interest standard applies to wholesale power contracts that incorporate market-based rates. The decisions fundamentally alter the *Mobile-Sierra* standard by creating a one-way ratchet according to which buyer's remorse—but not seller's remorse—can supply a basis for invoking the public interest to abrogate voluntarily-negotiated contract rates. In so-called "high rate" cases, the Ninth Circuit decisions hold, for the very first time, that the Commission *must* modify contracts in all instances where rates are deemed to be outside some subjectively defined "zone of reasonableness."

If the Ninth Circuit decisions are allowed to stand, the most immediate result would be the destabilization of the Nation's electricity markets. Next, because electricity generation is a large and fast growing user of natural gas, *see* APEC Region, at 143 (the "fastest growth in gas use is projected to occur in the electric power sector, with demand more than doubling"), the uncertainty those decisions have engendered in electricity markets will inevitably splash back into the market for the natural gas supplies used to fire much of the Nation's electric generating capacity. *See* FERC, 2006 State of the Markets Report, at 3 (2007) ("2006 Markets Report") ("[a]though we often consider energy markets as distinct (e.g., electricity and natural gas), they increasingly influence one another").

Under the Ninth Circuit's approach, generators that use natural gas to power generating facilities will be unable to rely on stable, long-term contracts to sell the electricity they generate. The precise adjustment that the markets will make to this unexpected legal development is not yet clear. But what is clear is that, precisely because they may no longer enter stable *sales* contracts with electricity customers, power generators may take a much different view of making the multi-million dollar commitments necessary to add new electric generation capacity—the great majority of which is fired by clean-burning natural gas. By calling into question the economic viability of facilities that purchase and consume natural gas, the decisions below cannot help but have substantial impacts on the natural gas industry.

Another likely result of the Ninth Circuit's doctrinal shift is a destabilization of electric power generators' purchases of natural gas on the spot market. *See generally* Eli Goldstein & Warren Young, Regulatory Failures and Regulatory Successes: The Case of U.S. Electricity Regulatory Reforms, at 8 (2002). The Ninth Circuit decisions, particularly the one-way ratchet set in place by those decisions, will discourage generators from entering into long-term contracts to sell electricity and undermine their ability to rely on existing long-term contracts. Long-term contracts that are voidable by electricity customers, but not by electricity generators, will be seen as having much less value from the perspective of generators. This will in turn render generators less willing and less able to make long-term commitments with suppliers of natural gas and other fuels, inevitably pushing greater volumes of natural gas transactions to compete for the more volatile supplies traded through spot market purchases. Generally speaking, the greater the proportion of natural gas sold through the spot market, and the more questionable the legal validity of the contracts used to hedge spot market risks, the more market participants of every description will be at the mercy of fluctuations in spot market prices.

For these reasons, the Ninth Circuit decisions make events like the California energy crisis of 2000-2001 more likely to recur. Moreover, because of the iterative nature of market responses in the closely related markets for electricity and natural gas, the Ninth Circuit's policies create circumstances conducive to a vicious cycle of instability across both markets. "Since the availability and price of natural gas directly affects electricity markets and electricity prices and because so much of the electricity generation added in the past decade, and planned to be added in the future, is gas-fired, all consumers across the Nation are likely to experience the impacts of energy price and supply volatility twice, on both their gas and electricity bills." National Association of Regulatory Utility Commissioners, Gas and Electricity Interdependence: The Current Situation and Intermediate and Long-Term Solutions, at 1 (2003). This Court's review is needed in order to short circuit this cycle before it begins.

II. The Ninth Circuit Decisions Introduce Uncertainty By Undermining The Principal of *Stare Decisis* And The Doctrinal Stability Of This Court's *Mobile-Sierra* Regime.

In addition to the Ninth Circuit decisions' indirect impacts on natural gas markets through their effects on electricity markets, NGSA and IPAA are concerned about potential direct adverse impacts of those decisions in the event they were to be improperly construed as applying to Commission-jurisdictional sales of natural gas. To be clear, despite similarities between the Natural Gas Act and the Federal Power Act, there are critical legal, factual, and economic distinctions that dispositively militate against extending the Ninth Circuit decisions to natural gas sales. Accordingly, even assuming the decisions below were correct in the electricity context in which they were decided (they are not), there still could be no legitimate basis for applying those decisions in the context of sales of natural gas.

In contrast to wholesale sales of electricity, a substantial proportion of natural gas sales are not subject to rate regulation by the Commission. Congress found that markets for natural gas at the wellhead and in the field were competitive and therefore decontrolled rates for so-called "first sales" of natural gas. *See* 15 U.S.C. § 3431(b)(1)(A) (2000) ("for purposes of [the rate provisions] of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable"). Accordingly, the Natural Gas Act now limits the Commission's ratemaking jurisdiction over sales of natural gas for resale in interstate commerce to subsequent sales. *See* 15 U.S.C. § 717(b) (2000). Moreover, the Commission has used its expertise and authority to pre-authorize non-"first sales" for resale at "negotiated rates." 18 C.F.R. § 284.402(a) (2007); *see also* 18 C.F.R. § 284.284(a) (2007). The Commission embraced this market-oriented approach based on findings that it could rely on "market forces at the wellhead or in the field" to constrain resale gas prices within the Natural Gas Act's "'just and reasonable' standard." *Pipeline Serv. Obligations and Revisions to Regulations Governing Self-Implementing Transp. Under Part 284 of the Commission's Regulations*, Order No. 636, FERC Stats. & Regs. ¶ 30,939 at 30,440 (Apr. 8, 1992), *on reh'g*, Order No. 636-A, FERC Stats. & Regs. ¶ 30,950 (Aug. 3, 1992), *on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *on reh'g*, 62 FERC ¶ 61,007 (1993), *aff'd in part and remanded in part sub nom. United Dist. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996).

The decisions below do *not* apply to Commission-jurisdictional sales for resale of natural gas. Nor do they purport to reverse the elaborate statutory and regulatory superstructure that has been built by

Congress and the Commission to develop and govern well functioning markets for natural gas. Nonetheless, the Ninth Circuit's willingness to depart from precedent in one context (market-based rate sales of electricity) suggests the possibility of comparable departures in a second context (market-based rate sales of natural gas). By raising the specter that its misguided decisions might come to infect market-based rate regulation of non-"first sales" for resale of natural gas, the Ninth Circuit has threatened the longstanding regulatory certainty secured by *Mobile-Sierra*. Such certainty is essential to well-functioning natural gas markets, because only stable and well known contracting rules can permit buyers to lock in particular prices and quantities of natural gas using negotiated contracts adapted to their own particular needs.

Although the Ninth Circuit decisions will have the most immediate impact on regulatory certainty in the context of electricity contracts, there can be no assurance that the decisions' ultimate reverberations will be so limited. If the Ninth Circuit can, at the stroke of a pen, discard a half-century-old legal standard as to one class of contracts, and if it can turn a balanced and parallel contracting rule into a one-way ratchet, what is to prevent similar treatment of the doctrine as regards other classes of contracts? What is to prevent innovations in other doctrines? And what, ultimately, is to prevent the Ninth Circuit or other lower courts from revamping *any* foundational rule governing energy markets?

The Ninth Circuit's policy innovations have broad implications for stability, predictability, and legal expectations throughout the energy industry. At present, "buyers of natural gas have options to reduce their exposure to volatile prices," both through stable contracts to buy physical gas, as well as financial hedging instruments. GAO, Meeting Energy Demand in the 21st Century, GAO-05-414T, at 16 (March 16, 2005); *see also* 2006 Markets Report, at 44 ("buyers and sellers would largely lose the benefits of hedging if there were no speculators willing to assume the risk that hedgers want to lay off"). At their most fundamental level, however, the decisions below have imperiled the viability of these risk-reducing options.

The *Mobile-Sierra* doctrine, and the respect for settled expectations it demands, may appear to the uninitiated as mere abstractions. But to participants in the Nation's energy markets, the doctrine is omnipresent. A simple search of the Westlaw legal database that collects Commission decisions shows that of the approximately 5,000 administrative decisions rendered by the Commission since 2000, over 600 (approximately one in eight) mention *Mobile-Sierra.* It may be only a slight exaggeration, if it is an exaggeration at all, to say that *Mobile-Sierra* is to energy regulation what the *Miranda* rule is to the law of criminal arrests. *Cf. Dickerson v. United States*, 530 U.S. 428, 443-44 (2000).

Although the Ninth Circuit did not hesitate to depart from the settled understandings of the Federal Power Act, this Court has long recognized that a set of stable and consistent legal rules serves crucial functions. *See, e.g., Payne v. Tennessee*, 501 U.S. 808, 828 (1991) (considerations "in favor of *stare decisis* are at their acme in cases involving property and contract rights"). As many of this Court's decisions have observed, clear legal rules discourage costly litigation that would otherwise entail substantial direct costs, and then impose still further costs by engendering additional rounds of follow-on litigation as needed to clarify any remaining uncertainty.

Energy suppliers, like other market participants, "require clear signals regarding national policies and confidence that those policies will be sustained over time in order to undertake the substantial investment needed to support expected increases in consumption." GAO, Meeting Energy Demand in the 21st Century, GAO-05-414T, at 7-8 (March 16, 2005). These important supply signals can only be scrambled if prices are to be set from time to time according to a heavy and unpredictable regulatory hand empowered by indefensible departures from judicial precedent.

This Court has often recognized that principles of *stare decisis* carry maximum force in contexts where, as here, statutory as opposed to constitutional policies are at issue. *See IBP, Inc. v. Alvarez,* 546 U.S. 21, 126 S.Ct. 514, 523 (2005) ("[c]onsiderations of *stare decisis* are particularly forceful in the area of statutory construction, especially when a unanimous interpretation of a statute has been accepted as settled law for several decades"). In addition, the Court has sometimes found it necessary to remind lower courts, including the Ninth Circuit, that only this Court may revisit one of the Court's own precedents. *See Maislin Indus., U.S., Inc. v. Primary Steel, Inc.,* 497 U.S. 116, 131 (1990) (once this Court has "determined a statute's clear meaning," it adheres "to that determination under the doctrine of *stare decisis*"); *see also California v. FERC*, 495 U.S. 490, 499 (1990) (recognizing the respect "this Court must accord to longstanding and well-entrenched decisions, especially those interpreting statutes that underlie complex regulatory regimes"). Against this backdrop, the Ninth Circuit decisions must be viewed as an assault, not only on the *Mobile-Sierra* doctrine, but also on principles of *stare decisis* more generally.

Any change in a legal regime that acts, as do the Ninth Circuit decisions, to replace settled rules with vague administrative directives necessarily opens a door to arbitrary agency decisionmaking. Having now "bargain[ed] in the shadow" of *Mobile-Sierra* for more than five decades, *Boston Edison Co. v. FERC*, 233 F.3d 60, 66 (1st Cir. 2000), energy market participants have ordered their affairs on the assumption that the Commission will be allowed to modify contracts only in accordance with *Mobile-Sierra*'s narrow and well-defined understanding of "extraordinary circumstances" of "unequivocal public necessity." *In re Permian Basin Area Rates Cases*, 390 U.S. 747, 820-22 (1968). Upsetting those expectations not only engenders uncertainty, it invites an interlude of impossible-to-predict agency reaction. The risk that market participants will be unnecessarily subject to the whim of uncertain Commission policies poses an undeniable further threat to the stability of our Nation's energy markets—one that can and should be defused by this Court's review of the decisions below.

CONCLUSION

For the foregoing reasons, and for reasons set forth in the petition, the Court should grant the writ of *certiorari*.

Respectfully submitted,

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